STATEMENT OF

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ON BEHALF OF THE
NATIONAL FARMERS UNION

BEFORE THE

FEDERAL CREDIT ADMINISTRATION

CONCERNING

OFIs AND ALTERNATIVE FUNDING MECHANISMS

AUGUST 3, 2001

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INTRODUCTION -

It is a pleasure to appear today to discuss credit issues as they effect the 300,000 family farmer and rancher members of the National Farmers Union and agricultural producers and rural communities in general.

The NFU believes that future economic success for farmers and ranchers is dependent upon access to an adequate amount of reasonably and competitively priced credit for production, and much needed value added venture capital. We believe this must be available to all producers who meet consistently applied eligibility criteria without regard to race, gender or operating scale.

BACKGROUND -

By many financial measurement tools, it would appear that U.S. agriculture is in reasonably good health and adequate credit is available from a wide range of traditional sources. However, the improved financial condition of agricultural lenders, the reduced level of loan delinquencies and charge-offs and the supply of credit are due in large part to a combination of factors that may not be sustainable, suggesting the financial health of agriculture is not as rosy as the data may suggest.

Since 1996, the federal government has provided about $69 billion in payments to agricultural producers through farm programs and additional economic support through a more broadly available crop insurance program that has improved participation incentives. Program payments include Agricultural Market Transition Act (AMTA) contract payments and loan deficiency payments or marketing loan gains as well as just under $30 billion in supplemental economic assistance since 1998. Subsidized crop insurance coverage has been expanded to more crops and regions and purchase incentives have been improved through both ad hoc programs as well as permanent legislative action in addition to the revival of annual production loss disaster assistance programs.

The financial situation of U.S. producers, agricultural lenders, other agricultural sectors and many rural communities would look entirely different if producers had been forced to rely solely on the market oriented promises of the FAIR Act and had not received annual infusions of new capital through the supplemental assistance provided over the last three years.

Although the current situation is significantly different than that which existed during the farm financial crisis of the 1980's, the underlying problem is much the same. The period leading up to the 1980’s crisis was characterized by significant inflation in production costs, fixed asset values and high nominal interest rates that were unable to be sustained by either the earning capacity of individual farms or alternative uses for agricultural resources. Increased debt loads were accommodated through equity financing based on inflated assets. When policies aimed at reducing the level of inflation pervasive throughout the economy were implemented, many farm families and their creditors were placed under great stress. The decline in land values resulted in a large number of family farm bankruptcies, agricultural bank failures and the near collapse of the farm credit system.

As a direct result of the late 1980’s experience, both farming and agricultural lending have undergone significant restructuring and consolidation. Agricultural lending standards have been modified to incorporate better analytical tools and focus more on cash flow and repayment capacity.

Changes in credit practices, when combined with a generally soft farm economy in terms of the relationship of prices received by farmers to prices paid, have contributed to the further consolidation of commercial farms and a noticeable shift in farm operation characteristics to the extremes. Increasingly, agriculture is characterized by a relatively small group of very large farms, i.e. with sales over $500,000 per year, leaving family farms behind. For many of these smaller operations, future economic success will be directly tied to their ability to participate in value-added ventures rather than expansion of farm size.

Commercial agricultural credit is generally obtained from four sources: commercial banks, Farm Credit System institutions (FCS), life insurance companies and supplier credit provided input suppliers, merchandisers and processors.

Banks and the FCS provide the vast majority of agricultural credit across a wide range of needs, while insurance company agricultural portfolios are almost entirely comprised of long-term real estate loans. Supplier credit ranges from intermediate or term loans generally for asset purchases to short term credit for the purchase of production inputs.

An increasing amount of credit is provided by input suppliers and processors through intermediate-term credit for asset purchases such as machinery and equipment as well as short-term operating credit based on accounts receivable for production inputs or commodity delivery contracts. This type of credit is provided not only by traditional input suppliers, but also from processor/merchandisers seeking to establish marketing arrangements, alliances or contracts with producers as well as influence the operator’s production decision-making concerning the mix of inputs utilized. While this type of credit provides additional financing options for farmers, it may also reduce the producer’s independence as well as reduce the longer term liquidity associated with his operation through both term loan indebtedness as well as less than competitive short term financing compared with traditional sources. In addition, it is not a source of funds for infrastructure or new business opportunities that benefit producers.

The structural and operational adjustments made by commercial banks and the FCS as a result of the 1980's experience, the more general consolidation of financial institutions in recent years, and the increased use of agricultural credit guarantees provided through the Farm Service Agency has resulted in greatly improved financial strength of commercial lenders and at least the appearance that an adequate level of agricultural credit is available at least for some borrowers. However, credit remains tight in terms of financial backing for new enterprises particularly among smaller producers or new market entrants.

The Farm Credit System had a 19.7 percent share of all farm operator debt. However, nearly 36 percent of its lending to farm operators was to operations with over $500,000 in sales but only 10.7 and 16.9 percent respectively of its lending was to operators in the Under $100,000 and $100,000 to $250,000 sales classes where farming was the primary occupation of the operator.

Similarly, the number of commercial agricultural banks declined by about 2900 banks or over 25 percent between 1992 and 1999. In 1999, commercial banks provided 43 percent to 50 percent of the credit in each USDA sales class, comparable to its 46.6 percent share of all agricultural debt. However, 21.4% of its lending portfolio to farm operators was to those with over $500,000 in sales while 15.1 percent was to operators with less than $100,000 in sales and 17.1 percent to those with $100,000 to $250,000 in agricultural sales.

CONCERNS AND RECOMMENDATIONS -

Credit Availability and Cost to Family Farmers

We are concerned that the impact of greater consolidation within the agricultural lending sector is resulting in structural changes in production agriculture that encourage and disproportionately benefit large-scale operations to the disadvantage of family farmers. These disadvantages affect small farmers in both farm production and participation in the value-added enterprises needed to ensure long-term sustainability of family farm operations. The composition of the loan portfolios of agriculture's two most important sources of credit appear to indicate that increasingly large operators are gaining at the expense of smaller producers in access, costs and credit terms.

We urge the FCA to consider, in any changes to its lending policies, the disproportionate lending practices to large producers versus family farm-size producers. The geographical location of all such lenders must be dispersed so as not to disadvantage those in the most rural areas. Further, borrowing costs must remain affordable and credit must remain available in the long term to ensure the program is effective for family farmers.

In addition, we strongly urge that any lending relationships between System and non-System institutions as well as any lending practices by both System and non-system institutions serve only farmers, ranchers, aquatic producers, their cooperatives, and farm-related businesses, rural housings and rural utilities, including infrastructure development.

Credit opportunities

We believe it is important to make credit available to meet an array of needs and opportunities for family farmers. We are concerned about the lack of credit available to new and beginning farmers. New, cost-effective innovations should be explored and implemented on a pilot program basis to encourage the intergenerational transfer of farming operations.

While credit is one important component of such an objective, we believe additional options should be explored utilizing USDA's credit guarantee authority through programs such as "aggie bonds" and private sales contract guarantees for farm purchase transactions by beginning farmers.

In addition, USDA FCS partnerships such as a grant-in-lieu-of-credit program from USDA limited to outlays similar to those associated with the cost of interest rate buy-downs could be effective in providing beginning farmers with the equity necessary to enter agriculture without the high leverage factor associated with credit programs.

Success in agriculture, particularly for beginning farmers, socially disadvantaged farmers and other smaller producers, is increasingly tied to market access and the ability to enhance the value of their commodities through processing and merchandising. Unfortunately, many of the producers who most need the ability to share in value added businesses, including farmer-owned cooperatives, are unable to generate the capital required for participation. We support expanding credit programs to include the financing of producer ownership of value added enterprises, and encourage the Agency to explore additional means to provide initial capital for the creation of new value-added cooperatives, including direct investments by agricultural lending institutions.

CONCLUSION -

The National Farmers Union recognizes the importance of credit as a risk management element in an unstable economic environment for producers and agriculturally dependent rural communities. We believe the public/private partnership in agricultural credit that has evolved among commercial banks, cooperative lending associations and the Department of Agriculture provides a generally positive model to ensure the availability and access to credit for responsible producers. However, we also believe Congress, USDA and the private sector can do more to ensure that access to those programs is equitable and that new innovations combining the strengths of the public and private sectors are explored to further enhance the success of family farmers and ranchers.

Thank you for the opportunity to appear today to discuss this important issue.