Policy Analysis

Cato Institute Policy Analysis No. 122: The Farm Credit Quagmire

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Executive Summary

As the savings and loan credit crisis blunders on, some commentators are proposing that Congress use the 1987 Farm Credit System bailout as a model for solving it. The savings and loan crisis and the farm credit crisis have much in common: Both were caused by politicians' camouflaging and transferring risks in an attempt to buy votes. Neither the savings and loan industry's regulators nor the Farmers Home Administration and the Farm Credit System really had a clear idea of how the subsidized credit programs were operating. And in responding to both crises, policymakers have avoided fundamental structural reform and instead simply injected cash and vastly expanded taxpayers' liability.

By flooding America's least competent farmers with easy credit and bailouts, Congress and FmHA have spurred a boom-bust cycle in farmland values, helped bankrupt many farmers, imposed huge entry barriers on young farmers, and driven up the cost of crop production, thereby undercutting U.S. exports. With each federal farm credit disaster, the government's dominance over agricultural credit has increased; FmHA and the Farm Credit System now effectively control half of the nation's farm debt.

Federal agricultural credit programs have been one of competent farmers' worst enemies. According to H. Allan Nation, editor of the Stockman,

> These government [credit] programs have been the very thing that has killed the family farmer by raising the price of land, equipment and inputs to levels insupportable by honest farming. The influx of the millions of dollars of FmHA money had the same effect on honest farmers that the millions of dollars of "dope money" had upon small businessmen in south Florida. There is no way to compete with a guy playing by another set of rules.(1)

FmHA was created to help the struggling family farmer. It ended up bankrolling John DeLorean's deluxe motorcar factory, lending $50 million to a single California farm (now bankrupt), and in 1985 alone giving almost $1 billion in subsidized loans to already-bankrupt farmers. To FmHA, incompetence is an entitlement.

The federal farm credit programs began when politicians proclaimed that farmers were being discriminated against in the credit market, and they continued to mushroom long after farmers had joined the ranks of the private sector's most favored borrowers. They have resulted in repeated disruptions of the agricultural sector's economy. In late 1988 the General Accounting Office estimated that FmHA had accumulated an operating deficit of $36 billion.(2)

Politicians have always viewed cheap credit for farmers as a magical, mystical panacea. Rep. Steve Gunderson (R-Wis.) observed in 1986, "If you want to increase [the] efficiency of a farm enterprise, give them a low-interest loan

and they'll be an efficient farmer."(3) No matter how much money FmHA squanders, Congress is dissatisfied and forces it to squander even more.

Federal agricultural credit programs are managed according to the principle that it is better for 10 inept farmers to be kept in business at any cost than for one deserving farmer to be forced to find a new profession. Programs are based on the principle that need is the basis of right--and that politicians are the best judges of need. Farm credit programs are a striking example of politicians' inability to allocate capital rationally and productively.

The Federal Government and the Land-Value Crash of the 1980s

It is not possible to understand the state of the agriculture industry in the 1980s without examining the massive expansion of federal farm credit programs in the 1970s. The more capital the government injected into those programs, the less stable agriculture became.

By the 1960s agricultural economists were complaining that the overcapitalization of agriculture had led to perennial surpluses and perennially depressed crop prices. In a 1984 speech William Lesher, the U.S. Department of Agriculture's chief economist, noted that "during the 1960s an average of 55 million acres per year were removed from production [by USDA programs], while at the same time FmHA loans for real estate were increasing at [a] 20 percent annual rate."(7) Although ample credit was available from private sources, federal farm credit programs exploded during the 1970s and the early 1980s. By injecting huge quantities of cheap credit into a sector of the economy that already had enough capital, the government helped to cause an artificial boom (and eventually a bust) in the land market. (Private banks, mistakenly assuming that farmland prices would rise forever, also jumped onto the bandwagon and provided easy credit to farmers.) It was simply "Give a loan, buy a vote" agricultural economics.

Between 1971 and 1983 the loan volume of the Farm Credit System soared from $14.8 billion to $82 billion, and the loan volume of FmHA increased fivefold. In 1985 Jonathan L. Fiechter of the Office of the Comptroller of the Currency observed, "From 1976 to 1981, farm debt doubled. The bulk of this lending came from the federal government and the Farm Credit System."(8) Charles Riemenschneider, then an agricultural economist at Chemical Bank and now staff director of the Senate Agriculture Committee, noted, "The share of farm lending supplied by government agencies rose to 48 percent by 1982, from 33 percent in 1972."(9) Between 1975 and 1984 FmHA's loan portfolio increased from $5 billion to $27 billion. Its 1979 loan volume was 50 times as large as its 1960 loan volume.(10)

The Farm Credit System, a network of farmer-owned banks whose loans were implicitly guaranteed by the federal government, persuaded Congress to allow it to lend farmers larger and larger percentages of the appraised value of their assets. Until the end of 1971 FCS could lend farmers up to 50 percent of the value of their assets; between 1972 and 1979 it could lend them up to 85 percent and often did so at rates that were 4 or 5 percentage points below those of commercial banks. As the Washington Post noted in 1987, all FCS borrowers were "charged the same interest rate in a given area regardless of their relative creditworthiness, with the rate kept as low as possible relative to the system's cost of acquiring funds to lend."(11) Thus, such FCS policies favored uncreditworthy borrowers.

In 1978 the American Agricultural Movement descended on Washington. Some of the farmers let loose a herd of goats on the floor of the House of Representatives; other farmers forced their way into USDA's headquarters and chased the secretary of agriculture, Bob Bergland, down the hall. (Bergland reportedly escaped through a window.) Congress saw the light and passed the Emergency Agricultural Act of 1978.

The 1978 act authorized FmHA to make "economic emergency" loans of up to $400,000, at 5 percent interest, for the repayment of other loans or any other purpose. The act's defini tion of the term "economic emergency" was "a general tightening of agricultural credit or an unfavorable relationship between production costs and prices received for agricultural commodities, causing widespread need among farmers for temporary credit." Any farmer "in economic stress due to unavailability of credit or cash-flow difficulties" was eligible for such a loan. The act's definitions of "economic stress" and "unavailability of credit" were so loose that almost every farmer who had been denied federal credit in the past could qualify for it. And once a farmer qualified for a subsidized loan, he was automatically eligible to receive an additional loan in each of the next four years. Thus, 1978--when Congress proclaimed an economic emergency in the agriculture industry-- turned out to be one of the most lucrative years in history for farmers.

The 1978 act prevented an economic adjustment in the industry and thus guaranteed that the eventual shakeout would be much worse. Between 1978 and 1980 FmHA made over $5 billion in "economic emergency" loans; by 1980 more than half of the loans were already delinquent. FmHA employees were given lending goals, and their careers depended on how much subsidized government money they could persuade farmers to accept. According to Vance Clark, FmHA's administrator from 1985 to 1988, FmHA employees would call up farmers and say, "Hey, do me a favor. Take $75,000."(12) They made little attempt to assess a farmer's ability to repay a loan because they assumed that land values would continue to soar forever.

Until 1979 the interest rate on FmHA loans for real estate purchases was fixed at 5 percent, which constituted a huge subsidy for people who wanted to buy farmland. In the late 1970s several states issued tax-free agricultural bonds to provide farmers who wanted to buy more farmland with loans at below-prime interest rates. Louisiana paid half of a beginning farmer's interest costs when he bought farmland. By giving farmers more and more money for chasing the same amount of cropland, government agencies helped send farmland prices into orbit.

In 1980, at the height of the land boom, Congress authorized FCS to make loans of up to 97 percent of the appraised value of a farmer's assets. Land prices had already tripled in the previous decade, and the 1980 legislation flooded the farm economy with even more cash. As a 1985 Wall Street Journal editorial noted, "The 1980 liberalization was lobbied for by extension services, land-grant colleges, the whole universe of farm-fed enterprises. It is no surprise that so much of that universe now sees it as a normal evolution for the system to be brought under pervasive national control."(13)

Land prices began to fall in early 1981--and by 1986 had plummeted by over 50 percent in Iowa, Nebraska, and Minnesota. Yet politicians and federal bureaucrats continued to urge farmers to stay in the business, announced one rescue plan after another, and kept promising that they could see the light at the end of the tunnel. FmHA's loan volume increased every year through 1986. As a result, many young farmers who should have sold out early, when the farm economy began to decline, held on until their entire net worth had been erased and they had no choice but to declare bankruptcy.

The injections of federal credit resulted in huge increases in farmers' debt and annual interest payments but little increase in their productivity--farmers spent most of the capital on bidding up the price of farmland. Those massive injections of federal credit, government-caused inflation, and, though to a much lesser extent, unwise lending by commercial bankers helped to bring about the inflated land values of the late 1970s. First USDA promoted farmland speculation; then, when the land market crashed, it declared that the only cure was more government power.

The Farmers Home Administration: A Comedy of Errors

FmHA seems to act on the premise that a farmer's problems are never his fault. In 1987 Sen. Patrick Leahy (D-Vt.), chairman of the Senate Agriculture Committee, called it "a bulwark in our defense against farm bankruptcy and foreclosure."(14) Many members of the committee judge FmHA solely by the farm bankruptcy rate. In that view, if the rate of farm bankruptcies is low, FmHA is a success; if the rate is high, FmHA is a failure--in which case the easiest solution is to give it so much money that no one will go bankrupt except by divine wrath.

FmHA is intended to serve as the lender of last resort for farmers who have been unable to obtain private credit. But a loan applicant should be considered creditworthy only if at least one lending source has judged him to be competent enough to entrust with the temporary use of other people's money. Politicians and bureaucrats have a contempt for creditworthiness; they believe that only they should determine who will have the use of other people's money. The government rakes in tax dollars and then gives them to farmers whom no taxpayer would willingly entrust with them. FmHA's main achievement has been to redistribute land from creditworthy farmers to people who have not proved that they can farm even rented land successfully. FmHA ensures that uncreditworthy farmers get capital on better terms than creditworthy farmers.

Moreover, because FmHA provides heavily subsidized loans, it is the lender of first choice for many farmers. FmHA offices often do not bother to determine whether farmers can get loans elsewhere, and many recipients of FmHA loans also receive credit from private sources. That makes a farce of the agency's purpose, but as long as the money keeps

flowing, politicians don't complain. And once a farmer qualifies for FmHA credit, the agency tends to continue financing him until the cows come home.

As a 1984 USDA study noted, FmHA's general policy has evolved into "providing credit to all farmers who for various reasons are unable to obtain credit elsewhere . . . at reasonable terms. The subsistence and large-scale operations are equally eligible for a loan" under that condition.(15) Although it was created to help family farmers, FmHA currently has outstanding subsidized loans to hundreds of corporations on its books. It apparently considers uncreditworthy corporations as deserving as uncreditworthy individuals.

There have been more FmHA loan recipients in Mississippi than in every other state except Texas. Among the "needy farmers" in Mississippi who have received FmHA subsidies are the lieutenant governor, a former governor, a member of the Republican National Committee, nine state representatives, and two state circuit court judges. When the state's FmHA director, Pete Perry, tried to block a $657,000 loan to a politically influential farmer who had already borrowed $7.4 million and fallen $4.3 million behind in repayments, he was fired. Mississippi's next FmHA director quickly gave the farmer the loan.(16) In 1984 the state's FmHA director also served as a private attorney for one of the agency's largest borrowers.

An excellent 1983 investigation by Gannett News Service reporters Mark Rohner and Dennis Camire revealed that FmHA had lent $1 million to a rich Mississippi real estate speculator, who used the money to pay off his other debts; lent $11 million to an inept farm company whose top officer had been convicted of defrauding a bank of which he was president (and then, turning the other cheek, lent the company another $3.7 million after the man had served six months in prison); and lent $1 million to an enterprising individual who had persuaded an FmHA loan officer that he could get rich by playing the commodity futures market (he lost it all).(17)

FmHA's credit policies are totally divorced from financial reality. In 1979 a Mississippi farmer who was almost debt-free accepted a low-interest FmHA disaster loan of $41,300, thus becoming automatically eligible to receive an additional subsidized disaster loan in each of the next four years. By 1983 the farmer owed FmHA $661,000 and had a negative net worth of more than $500,000. So FmHA gave him another $204,000 to enable him to put in another crop and stay on the land for another year.(18)

An FmHA supervisor in Washington County, Mississippi, told federal auditors that he was "too busy making new loans to evaluate" how a farmer was using a $1.7 million loan. After the farmer went bankrupt, the FmHA supervisor told auditors that he was "too busy" to put liens on the farmer's equipment.(19)

FmHA's "generosity" has disrupted many rural Mississippi towns.

> In the community of Drew, Mississippi, blunt-spoken Mayor W. O. "Snake" Williford thinks his area faces a desperate farm debt crisis today in part because of the liberal FmHA loan policies Congress has decreed. They have led some farmers "down the path to ruin," Williford said. "FmHA loaned some money they shouldn't have loaned to people that shouldn't have had the money. You're not doing them a favor when you lend them more than they can repay."(20)

As Alex Ramsay, who farms in Mount Olive, Mississippi, com- plained,

> The program has split the farming community between the "FmHA farmers" and bank farmers. Those of us who worked for years to build equity in our operation and credit at the bank suddenly found [that] the poorest managers--or those who had never farmed anything more than a pea patch--were overnight wonders with the biggest tractors, newest combines, [and] fanciest trucks and bid up land rents far beyond their value, all paid for with money they had not earned and had neither the ability nor the intent to repay.(21)

In 1983 USDA's Office of the Inspector General reported that FmHA's official policy was to lend money to farmers who could not repay their previous loans and had "little or no chance" of repaying new ones. Charles W. Shuman, FmHA's administrator from 1981 to 1985, defended that policy as follows:

> If the Agency had taken a firm stand against all its delinquent borrowers and had forced a large number of those borrowers out of business . . . it would have aroused political concerns which might very well have resulted in legislation mandating the Agency to temporarily cease all foreclosure actions, provide moratoriums on loan repayments, forgive principals, or mandate other unsound credit management policies.(22)

In other words, if FmHA did not waste money voluntarily, Congress might pass a law that forced it to waste money. In order to prevent Congress from dictating "unsound credit management policies" to FmHA, the agency's officials beat Congress to the punch--and thereby saved the honor of the Reagan administration. They have apparently resolved never to let Congress take taxpayers' money alive. As a federal employee commented, FmHA's policy is to tell prospective borrowers, "You can't repay your loans, so here's another one."(23)

One of FmHA's more memorable projects was a series of loans to some California flimflam men. In 1985 Bob Cox and Ronald Campbell reported in the Bakersfield Californian that FmHA had lent a total of over $50 million to Tex-Cal Land Management Inc. of Delano.(24) That FmHA loan project might turn out better than the rest; FmHA could recover as much as $10 million after Tex-Cal's bankruptcy proceedings are com- pleted.

Although recipients of FmHA loans are supposed to be incapable of borrowing money in the private sector, Tex-Cal had borrowed $7 million from Aetna Life and Casualty Insurance Company only a few months before it received its first FmHA loan. The company owned little or nothing, though it did lease 7,000 acres of vineyards and almond orchards. Much of that "agricultural" land was in poor condition, however, and much of it was bulldozed after Tex-Cal finished using FmHA money to "improve" it. Bud Steele, Tex-Cal's manager, commented at the company's trial, "I've always been amazed at how FmHA could loan money to a corporate shell with no assets."

Michael Asher, an independent appraiser employed by FmHA, was fired after he cited flagrant inaccuracies in Tex-Cal's claims about the boundaries of its land. Asher said in 1985, "FmHA didn't give a damn whether we have good legal descriptions or not. The agency's attitude was 'Don't confuse me with facts. Just let me loan money.'" The FmHA office in Kern County did not even have an accountant to check the farmers' figures. According to Asher, FmHA told its appraisers not to bother calculating yield per acre when making their loan evaluations. FmHA also told its customers to complete repayment forms, a job normally done by bank credit analysts. The agency brought in special "loan experts," but a local farm finance expert commented, "Some of them didn't know what a cotton plant was."(25)

As Cox and Campbell reported,

Tex-Cal Land Management got its first three loans July 16, 1979. About five and a half months later, it missed the first installment of $504,000 and began pleading for more money. The FmHA didn't blink an eye when Tex-Cal Land Management first failed to pay.

> When Tex-Cal Land Management returned for another $9.4 million in 1982, [FmHA administrator Charles] Shuman decided to crack down. . . . As conditions for a $5 million loan, he insisted Tex-Cal Land Management submit to an independent audit, stop using federal money to plant new vineyards and orchards, accept FmHA supervision of its bank account and crop proceeds and acknowledge that "this is the last loan FmHA intends to make."
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> It is clear now that FmHA officials realized as early as 1983 that they had a problem on their hands. At that point, Tex-Cal Land Management had borrowed more than $30 million, and had paid back virtually none of it. But then . . . Shuman approved an additional $6 million in crop loans that year after laying down strict conditions, including an audit of the company's books. But no audit was done.
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> And despite Shuman's earlier warnings, Shuman authorized what eventually would amount to $15.2 million in "protective advances" in late March 1982.(26)
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> According to Gannett's Rohner and Camire,
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> FmHA's internal procedures are so cumbersome that the guys on the firing line--the FmHA county

supervisors who must okay the loans--often need a crystal ball to interpret headquarters' pronouncements. Recently, FmHA officials in Washington proudly told auditors that their loan officers in farm counties now stress managing loans already made, rather than handing out new ones. So the auditors asked the FmHA county supervisors. About half--81 of 172--hadn't gotten the word.(27)

FmHA draws up a "farm and home plan" for each of its loan applicants to help them manage their finances. "But a 1983 audit found 102 of 202 plans surveyed were inaccurate or unrealistic--'worthless,' in the auditors' words. Some plans, they said, were 'so obviously inaccurate or unrealistic [as] to appear deliberately manipulated to establish eligi bility for additional loans.'"(28)

FmHA apparently believes that everyone deserves another chance to succeed--with someone else's money. But according to the agency's records, by far the most frequent cause of bankruptcy among its borrowers is "poor farming practices, such as inadequate care of livestock or crops."(29) For instance, FmHA provided several loans to a Wisconsin dairyman, and "FmHA file documents indicate [that] the borrower was not completing necessary farm work and not properly caring for the dairy cows. Many cows died."(30) The General Accounting Office routinely found cases of FmHA borrowers' "planting crops on land too poor for good production" as well as "inadequate fertilization and weed and insect con- trol."(31)

FmHA's records also indicate that almost one-quarter of the bankruptcies among its borrowers were largely due to their having received too many loans.(32) It is likely that those records seriously underestimate the number of borrowers FmHA has sunk. FmHA makes a loan and then lends the recipient more and more money, piling up the debts until he drowns. Moreover, FmHA is encouraging struggling farmers to continue farming. As of early 1986 the average FmHA borrower had a net worth of $73,000. Eighty-five percent of the FmHA borrowers were losing money farming; the average borrower in that group had an annual negative cash flow of $56,000. If the average FmHA borrower had sold out at the beginning of 1986, he could have left farming with a cash sum greater than the net worth of a typical American family. But at the average loss rate, by continuing to farm he would go bankrupt within 16 months.(33)

In 1985 the average debt-to-asset ratio of farmers who were FmHA borrowers was 83 percent--compared with 26 percent for all farmers. A debt-to-asset ratio of over 40 percent is usually considered a danger sign, according to USDA's Economic Research Service. In 1986 new FmHA borrowers had an average debt-to-asset ratio of 70.6 percent--which means that most of them probably should have sold out while they still had title to their homes instead of staying in farming until they had a negative net worth.(34) Many farmers who might have survived if they had rented farmland in the early 1980s instead used FmHA loans to buy land--and then were wiped out when farmland values crashed.

FmHA borrowers have the same problem as Third World governments that obtain cheap loans from the World Bank. An uncreditworthy farmer is unlikely to use the government's money productively enough to be able to pay back the debt- service costs and the principal. If a farmer puts his cheap FmHA loan funds into a certificate of deposit paying high returns, he will probably profit from FmHA's generosity. But even a loan at a subsidized interest rate is of no benefit if the borrower does not use the principal wisely. Moreover, he will have to increase his productivity in order to service the debt. The debt-service payments required for a large FmHA loan often equal half of a farmer's production costs. A farmer who receives such a loan acquires a huge new cost overnight.

The farmer is then faced with endless reschedulings and de facto defaults--like Mexico, he is always struggling, never able to get his head above water, always postponing his financial doom. General Accounting Office analyst Brian Crowley noted that "some of these people are borrowing themselves into oblivion. They continue to borrow . . . until they burn up what little equity they have left. At that point they are forced to leave farming and have nothing to show for their years of hard work."(35) FmHA does farmers no good by throwing them a lifesaver made of lead.

By law, a farmer who has defaulted on an FmHA loan and lost his land has the first option to buy the land. If he chooses to do so, he will be eligible to receive a subsidized FmHA loan that year and in each subsequent year. FmHA sells the land back to such a farmer at a much lower price--a price that supposedly will enable him to generate a large enough cash flow to service his debts. But FmHA's estimates of cash flow are notoriously inaccurate, and the error is

usually in the borrower's favor. Thus, many farmers are rewarded for losing the farm that taxpayers gave them by being awarded another quarter million of taxpayers' dollars with which to buy the farm again and roll the dice again.

FmHA's delinquent debt load is now decreasing, largely because FmHA is writing off much of its borrowers' debt. As a Senate Agriculture Committee report on the Agricultural Credit Act of 1987 noted, "To be eligible for FmHA debt restructuring, the delinquency must be due to circumstances beyond the control of the borrowers, [including] declines in farm prices, farm income, and farmland value."(36) In other words, Congress says, "We will give you this loan at a subsidized interest rate--but if farm prices decline, you don't have to pay us back." Do housing loans contain a clause stipulating that the borrower doesn't have to pay the bank back if housing values fall? Do automobile loans contain a clause stipulating that the borrower's obligations will be waived if the car has a flat tire?

Recipients of FmHA subsidies are chosen largely by county committees of farmers. But in responding to a query from the Senate Agriculture Committee, an FmHA representative said, "We have had, and still have, cases where a county committee has been coerced into determining an applicant eligible by the pressure the applicant can bring to bear in a community. As a result, . . . ineligible applicants receive FmHA assis- tance."(37) Instead of reforming the county committee system, Congress made it much worse through the 1987 act. If a farmer is turned down for a loan by his county's FmHA committee, he can now appeal to the state FmHA committee, which can overturn the decision. But if the county committee declares a farmer eligible for a loan, the state committee has no power to overturn the decision.

FmHA's Farm Ownership Outreach Program is designed to persuade Hispanics, blacks, native Americans, Asian-Americans, and Indian and Pakistani immigrants to apply for subsidized loans and go into farming. Members of those groups can qualify for aid more easily than other applicants because the government considers them "socially disadvantaged." With such criteria for loans, there should be no shortage of farm bankruptcies in the 1990s.

As FmHA's administrator, Vance Clark made an honorable effort to clean up the agency's mess. Clark observed that some FmHA loan applicants "don't even possess a basic farming ability--they are selling used cars and they decide to come to us and become a farmer."(38) Kathleen Lawrence, who had been a USDA deputy assistant secretary between 1983 and 1987 and had supervised farm credit programs, noted, "In many other small businesses you start out working for somebody else, and you salt away your money so that someday you can open your own business. When you do start your business, you lease your office space, you lease your computers, and then eventually you buy your own computers and your own office buildings."(39) But farming is different--or at least Congress seems to think so.

When FmHA proposed to limit the amount it lent to those who had defaulted on its previous loans, the Senate Agriculture Committee condemned it for attempting to bring about the "disenfranchisement" of the borrowers. But to speak of the disenfranchisement of uncreditworthy subsidized borrowers is to imply that some people have an innate right to waste other people's money by playing farmer. Bruce Van Sickle, a federal district judge, barred FmHA from foreclosing on such a loan in 1983, claiming that doing so would be unconstitutional because one of the foreclosure forms did not contain enough information to satisfy "due process." Van Sickle's decision was a landmark extension of the right of access to taxpayers' dollars. No judge will ever strike down an IRS form for lack of due process, but government handout recipients apparently have far more constitutional rights than the people who provide the handouts.

FmHA is still subsidizing people to charge into farming even though it is obvious that parts of the industry are already overcrowded. If FmHA had stopped lending when agriculture became less viable, 15,000 bureaucrats would have no excuse for holding jobs. After auditing FmHA's rural housing lending program, USDA's Office of the Inspector General concluded that "many FmHA field personnel were reluctant to classify urban areas as ineligible due to the resulting decrease in loan-making activity."(40) Such programs end up benefiting FmHA employees rather than achieving their stated goals.

FmHA acts as if tax dollars were meant to be burned. An IG report noted that FmHA offices were making no effort to collect almost $1 billion in defaults on guaranteed loans because FmHA believed that "losses on guaranteed loans were too small to be concerned about." When a borrower in Texas offered to repay an FmHA loan on which he had defaulted, FmHA told him to repay his bank and then made no effort to recover the money from the bank.(41) Under one loan program, FmHA lends money to farmers who are not eligible for its regular loans so that they can purchase

farms in its inventory. But FmHA, unlike sober private banks, does not always verify the financial information in loan applications. The natural result: massive losses and endless scams.(42)

FmHA is now the nation's largest owner of farm property; its inventory contains almost 20,000 farms. Regrettably, FmHA is managing its farmland with the same degree of skill that it applies to managing credit programs. It has leased out hundreds of thousands of acres, but a 1987 USDA report noted that 90 percent of FmHA's county offices had no formal system of monitoring leases and that in many cases "county supervisors forgot about the lease payments."(43) Often the property acquired by FmHA deteriorates so badly that it depresses the value of its surroundings.

Moreover, only 9 percent of FmHA's surplus property was listed with realtors even though FmHA personnel admitted that they had no time to sell it. Often FmHA's only effort to sell such property was to post a "for sale" sign. Rep. Jim Ross Lightfoot (R-Iowa) discovered that FmHA was refusing to take bids above the asking price--another breakthrough in bureaucratic efficiency.(44)

Many FmHA programs are fundamentally idiotic. The agency gives rural families 30-year loans for the purpose of buying trailer homes even though most trailers die before age 15. According to Sheldon Rose, a real estate developer in Michigan, "30-year financing for mobile homes is totally unrealistic. Some trailer parks ban trailers older than seven years because the older homes become so tacky-looking."(45) Another FmHA program provides low-interest loans of up to $300,000 to enable farmers to retain foreclosed homes and five acres of land. In most rural parts of America $300,000 can buy a mansion. Thus, some of the homes that taxpayers are forced to provide for farmers are far nicer than their own.

FmHA also has a program that provides loans at an interest rate of 1 percent to enable farmers to build housing for laborers. But other USDA programs pay the same farmers for idling their land and throwing farm workers out of jobs--and out of the new FmHA-subsidized housing.

Members of Congress seem to believe that it is better for an incompetent farmer to fail than for him to become a competent carpenter, truck driver, or salesman. They want FmHA to keep farmers in business at any cost. Responding to reports that FmHA had advised some farmers to quit farming, Rep. Byron Dorgan (D-N.D.) said in 1985, "What kind of govern- ment is it that counsels agriculture's future to get out of agriculture? That says to young farmers, 'You ought to quit.' That is not a government that has its priorities right."(46)

FmHA has done farmers far more harm than good. Most FmHA borrowers are headed for bankruptcy--and could be saved only through a widespread forgiveness of loans. Many non- FmHA-funded farmers have been hurt by the high rents and land values caused by the agency's programs, and all non- FmHA-funded farmers have been hurt by the surplus production subsidized by FmHA.

The Agricultural Credit Act of 1987

In the name of kindness, the future creditworthiness and productivity of American farmers are being sold down the river. Thanks to the Agricultural Credit Act of 1987, FmHA and the Farm Credit System now function far more as welfare agencies and far less as credit agencies. Because those two government entities jointly hold over half of the nation's farm debt, their policies are a major impediment to the efficiency of American agriculture. FmHA's stratospheric delinquency rates and the perennial mismanagement of FCS should have been sufficient proof of the government's inability to manage farm credit intelligently. Yet the 1987 farm credit bailout was designed to give the government even more dominance over agricultural credit and will likely cost taxpayers at least $10 billion.

When FmHA announced in early 1988 that it would be writing off almost $9 billion in loans, the news sparked a backlash from farmers who had struggled to stay current with their loan payments. Bernard Cohrs, a farmer in Dickinson County, Iowa, said that he was outraged because while he was struggling along with an old pickup truck and making his loan payments on time, the officers of Terafact Inc., a local corporation that had recently had its FmHA loan restructured, were driving brand-new Mercedes-Benzes.(47) Jerome and Kathryn Berg, a farm couple in Sigourney, Iowa, complained in a letter to Rep. Joseph DioGuardi (R-N.Y.), who had led a fight against FmHA debt forgiveness in the House of Representatives, "Many of those with debt write-downs are again buying more land and expensive equipment, cars, and trucks and living it up, while the rest of us, who paid our bills and lived within our

means, are now expected to help bail them out."(48) Robert A. Dreyep, a farmer in Fenton, Iowa, complained that FmHA was "rewarding the poor managers, who are also very inefficient farmers."(49) Robert B. Delano, the president of the Virginia Farm Bureau, observed, "The only reason I can figure [for FmHA's debt forgiveness] is [that] this is an election year."(50) Oscar T. Blank, the director of FmHA's Indiana office, declared, "As a farmer, I'm unhappy about it. We already have huge surpluses, yet here we are keeping farmers producing. We may have too many farmers in this country, and this is just going to keep the inefficient ones on the land."(51)

Members of Congress have defended FmHA's multibillion- dollar loan write-off by claiming that it is cheaper for the agency to forgive loans than to foreclose on delinquent farmers. FmHA is supposed to forgive loans only when doing so would save money, but Congress has mandated a method of calculating costs that is heavily biased in favor of loan forgiveness. Local FmHA offices are notorious for greatly overestimating farmers' potential income when evaluating their eligibility for new loans, and the same practice is being used to justify the conclusion that loans should be forgiven. Moreover, farmers whose FmHA loans are forgiven are effectively entitled to receive additional subsidized loans in the future, yet Congress has forbidden FmHA to consider the cost of future loans when comparing the probable costs of foreclosure and debt forgiveness.

The 1987 act vastly expanded the so-called borrowers' rights enjoyed by those who do not pay back government-guaranteed loans from FmHA or FCS. Rep. James Jeffords (R-Vt.) said, "We ought to give farmers a better opportunity than they would get from commercial banks in the event that they go through hard times."(52) At the same time that another arm of the government is making a more energetic effort to collect on overdue student loans, the congressional agriculture committees are making it extremely difficult, if not impossible, to collect on overdue farm loans. The "borrowers' rights" that farmers now enjoy essentially entitle them to acquire other people's money under little or no obligation to pay it back. Kathleen Lawrence, the former USDA deputy assistant secretary, observed, "If you end up having the kind of lawsuits filed against the Farm Credit System and [having] restraining orders to prevent foreclosures in place, then you will end up turning the Farm Credit System into another Farmers Home Administration."(53) FmHA administrator Vance Clark noted, "We are the only agency in government that is prohibited from using private debt collection agencies."(54)

In 1986 Congress revised the bankruptcy laws so as to make it much easier for a farmer to default on his loans and still keep his farm. However, Congress realized that the revision would cause bankers to be leery of lending money to farmers, given that it made them an elite class that had a lesser legal obligation to repay its loans. So to ensure that farmers could obtain ample credit, Congress created a federally guaranteed secondary market for farm loans by establishing the Federal Agricultural Mortgage Corporation through the 1987 act. As a result, when farmers default, it is the taxpayers, not private bankers, that suffer.

FAMC (known as Farmer Mac) is authorized to guarantee loans of 80 percent of the value of a farmer's assets--even though USDA believes that any farmer with a debt-to-asset ratio above 40 percent is at financial risk and generally considers a farmer with a ratio above 70 percent a lost cause. FAMC can provide implicit government guarantees for loans up to $2.5 million--a nice cutoff point between the needy and the greedy. "It is Farmer Mac that is going to keep the commercial banking industry and the insurance industry in the agricultural sector," Lawrence observed.(55) By forcing the government to cover the cost of bad farm loans, Congress has ensured that more capital will be squandered on inefficient agricultural investments.

Politicians and Credit: A Bad Mixture

In 1980, during his tough battle for reelection, President Jimmy Carter reportedly urged his secretary of agriculture, Bob Bergland, to give Georgia farmers more FmHA loans. Bergland replied, "Jimmy, we already spent a billion dollars in Georgia. The whole state is not worth a billion dollars." As of early 1987 Georgia had the highest FmHA delinquency rate in the nation--73.4 percent.(56)

The federal farm credit program is actually a huge welfare program that Congress has cloaked in the trappings of financial respectability. It is much easier for politicians to defend a $50 million loan than a $50 million handout, so they have created a "credit" program that makes subsidized loans of up to $50 million, requires only that an applicant appear uncreditworthy, and is totally incapable of foreclosing on delinquent debts.

Politicians profit from the farm credit program according to their generosity, not the soundness of the loans. In early 1987 FmHA proposed to enact regulations that would enable it to rate prospective loans according to their riskiness. Congress was outraged, of course. Representative Dorgan exclaimed, "These regulations could effectively be used to destroy the mission of the agency, to disqualify from loans exactly the type of farmers Congress intended the agency to serve." FmHA loses money because Congress designed it that way.

Whenever subsidies are distributed on the basis of vague or illogical criteria, political pull will determine who gets the handouts. Local and state FmHA offices receive numerous telephone calls in which congressional staffers try to pressure them into lending money to campaign contributors and other politically preferred borrowers. FmHA has thus become a petty-cash drawer for farm-state congressmen; it is notorious for its old-boy network.

Many people assume that when a farm goes bankrupt, the land vanishes and the farmer dies. In 1985 Bill Kerrey, an agricultural adviser to the governor of Nebraska, told the Washington Post, "I consider anything above 1 percent in farm and ranch turnover to be too high."(57) What actually happens in a farm bankruptcy is that the farm is simply turned over to another individual (or corporation), who then attempts to make a profit off the same turf. The amount of land in production (or generating subsidies for being out of production) stays roughly the same. In Minnesota, 90 percent of the farms on which FCS had foreclosed were purchased by neighboring farmers. The amount of cropland in the United States has changed little over the past 60 years despite a decrease in the number of farmers; it was 382 million acres in 1930 and 383 million acres in 1982.

Farm credit policies are usually legislated in an atmosphere of hysteria. Rep. Tom Daschle (D-S.D.) remarked in 1985 that "the single most impressive fact is our estimate that at least 20 percent of this country's farmers will lose their operations within 18 months if nothing is done--soon."(58) On February 9, 1985 the front page of the New York Times reported that "2.37 million farmers [were] struggling to pay interest on total liabilities that [had] soared 63 percent since 1979, from $132 billion to $215 billion."(59) That report was grossly inaccurate; only about 400,000 farmers were struggling to pay the interest on their debts. In 1987 Harold F. Breimyer, a University of Missouri professor long known for advocating more farm subsidies, warned, "Half of all full-time farmers are in jeopardy."(60) As usual, a farm credit law was passed because the conventional wisdom was that all American farmers would soon be homeless unless Congress immediately gave agriculture another major injection of funds.

A Conspiracy against Competence Federal farm credit handouts are a classic case of self-defeating humanitarianism. The more money the government lends a farmer, the less money other farmers will receive for their harvest. Congress may say that it is helping farmers, but what it is really doing is subsidizing competition for other farmers. Every FmHA loan goes either to a farmer who could obtain credit elsewhere or to an uncreditworthy farmer--who is thus kept on the land, to the detriment of the creditworthy.

Congress has created two classes of farmers: welfare farmers and self-reliant farmers. Every dollar of aid the government gives to welfare farmers makes it more difficult for self-reliant farmers to survive. FmHA's officials recognize that its loans hurt farmers who are not its clients. At a 1987 hearing on the Senate Agriculture Committee's proposed changes in FmHA's credit regulations, Clark said, "Land is bid up because the landlords know there's cash rent available through our program. . . . We find our borrowers bidding against other borrowers and up goes the rent, which really works to [borrowers'] detriment."(61)

Some FmHA loan clients have been technically bankrupt for over eight years, but FmHA keeps giving them annual loans to "keep them in business" and thus keeps them producing surpluses that drive down the prices other farmers can command. Good farmers have been forced to pay inflated prices to acquire more land because the government had bid up the price of farmland by bombarding bad farmers with cheap loans. In 1987 FmHA clients in North Dakota were getting operating and ownership loans at 4.5 percent interest; other North Dakota farmers were paying up to 13 percent.

FmHA cannot bail someone out without preventing someone else from entering farming or expanding his operations. Giving subsidized loans to a beginning farmer creates higher entry barriers for other beginning farmers. In some states-- such as Louisiana, where more than 50 percent of the farmers are on the FmHA dole--nonsubsidized farmers are at a huge disadvantage. And the higher land costs become, the more politicians and bureaucrats cite those costs as proof

that more subsidized credit was necessary.

In recent years FmHA has followed a farmland anti-takeover policy--preventing competent farmers from buying incompetent farmers' land. Most of the land farmed by FmHA clients would have been farmed even if FmHA had never existed. The only difference is that the land is farmed by someone who cannot stay in business without receiving $100,000 worth of tax money each year rather than by someone who can make a profit and pay taxes.

FmHA loans have made farming more capital-intensive. They have encouraged many owners of relatively small farms to buy expensive machinery instead of hiring laborers. Because such farms are often too small to justify the use of large equipment, it is idle for much of the year, which reduces the farmers' efficiency. Thus, FmHA has succeeded in both destroying jobs and reducing productivity.

How Politicians Allocate Capital

The federal government's farm credit policy conflicts with some of its other farm policies. In 1987, when the Agricultural Stabilization and Conservation Service offered farmers 92 percent of their federal deficiency payments as a reward for taking a year's vacation, some farmers received millions of dollars in FmHA loans, then collected millions more for not planting crops. In 1983-84, when dairy farmers were paid almost $1 billion for slashing milk production, FmHA lent dairy farmers millions of dollars to help them increase milk production.

In early 1986 the General Accounting Office reported that half of FmHA's $28 billion loan portfolio was being held by farmers who would probably default and that in the first six months of 1985 alone the agency had lent almost $2 billion to farmers who were already technically bankrupt or nearly bankrupt, including farmers who had not made a payment on previous FmHA loans in over four years. That extraor- dinarily high delinquency rate would be much higher if FmHA had not partially forgiven or rescheduled and reamortized the debts of about 45,000 farmers. Farm-state legislators responded to the GAO report not by declaring that any government agency that could burn up so much money ought to have its charter reexamined but by continuing to denounce FmHA for not being more generous.

The federal government's farm credit policy is one of the clearest refutations of the notion that politicians can manage the economy better than private citizens. A rational policy would consist of directing capital to wherever the returns would be highest and shifting capital away from other investments. But for decades the federal government's policy has consisted solely of injecting as much capital as possible into the farm economy regardless of the effects. For politicians, the solution to low returns in agriculture is always to provide more capital. The cheap credit creates an illusion of prosperity in the industry and thus helps them make it past another election.

Conclusion

Dwight Coleman, a North Dakota farmer who led a class- action lawsuit that forced FmHA to cease foreclosures in 1983, summed up his experience with government credit as follows: "If you can't borrow money from the local banker, stay out [of farming]. Lease your land instead of borrowing heavily, and don't borrow from the government at all."(62) Coleman recognized the dangers of succumbing to the lure of subsidized credit. If only Congress were as wise. Wheeler McMillen observed in 1929, "If a farmer doesn't have enough pride and business about him to keep his credit good, certainly no one in the world is going to be able to do much for him."(63) The subsequent record of bankruptcies and delinquencies incurred by borrowers of FmHA and FCS funds supports his view.

If FmHA were a bank, would anyone of sound mind deposit his money there? Would anyone allow FmHA to use his personal savings the way it uses his tax dollars? It is obvious that members of Congress feel no obligation to taxpayers in deciding how to manage farm credit programs and have no sense of personal responsibility when such programs malfunction and disrupt the farm economy.

Politicians love to play Santa Claus with other people's money. That is why FmHA was created; that is why it grew; and that is why it is prospering even though its loans have helped wreck thousands of subsidized farmers' lives and created unfair competition for unsubsidized farmers. In farm policy discussions, "credit" is usually a euphemism for either a handout or a bailout.

Because there is a limited amount of capital available in America, every subsidized loan to a near-bankrupt U.S. farmer means fewer loans for other Americans. For each subsidized farm loan of $400,000, as many as eight families are denied enough capital to get mortgages on their first homes. For each subsidized farm loan of $1 million, 20 entrepreneurs are denied enough capital to start their own businesses. The government is crowding private citizens out of the credit market--which means that politicians and bureaucrats are gaining more control over everyone else's lives.

As long as members of Congress are not guaranteed lifetime positions and must seek reelection, they will deny that agriculture is overcapitalized. There is no evidence that congressional committees' management of farm credit programs has improved since 1916.

Congress treats inefficient farmers the way a pusher in an FBI film treats heroin addicts, constantly assuring them that just one more fix will solve their problems. By doing so, Congress helps to ensure that those farmers will never be able to make it on their own and will always be in need of more subsidized credit. Cheap farm credit has created a boom-and-bust cycle in land values, prevented the agriculture industry from adjusting to changing circumstances, impaired U.S. competitiveness, and kept people who will never be successful at farming struggling to succeed.

FOOTNOTES

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(4) Wheeler McMillen, Too Many Farmers (New York: William Morrow, 1929), p. 27.

(5) Cassius M. Clay, The Mainstay of American Individualism (New York: Macmillan, 1934), p. 215.

(6) Ezra Taft Benson, Freedom to Farm (Garden City, N.Y.: Doubleday, 1960), p. 119.

(7) William Lesher, paper presented at the Conference on Alternative Agricultural and Food Policies and the 1985 Farm Bill, Berkeley, Calif., June 11, 1984.

(8) House Committee on Banking, Finance, and Urban Affairs, Farm Debt (Washington: GPO, March 20, 1985), p. 80.

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(10) Michael Boehlje, Agriculture Policy and Financial Stress (Washington: American Enterprise Institute, December 1984).

(11) Washington Post, March 1, 1987.

(12) Vance Clark, interview with author, February 24, 1988.

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(30) U.S. General Accounting Office, Farmers Home Administra- tion: Federally Acquired Farm Property Presents a Management Challenge (Washington: GPO, June 1986), p. 23.

(31) Ibid., p. 22.

(32) U.S. General Accounting Office, *Farmers Home Administration: Problems and Issues Facing the Emergency Loan Program* (Washington: GPO, November 1987), p. 42.

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(39) Kathleen Lawrence, interview with author, July 3, 1988.

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(57) *Washington Post*, May 13, 1985.

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(60) *Washington Post*, March 26, 1987.

(61) Senate Committee on Agriculture, *Proposed Changes in FmHA Credit Regulations*, p. 22.

(62) *Fargo Forum*, February 7, 1987.

(63) McMillen, p. 66.