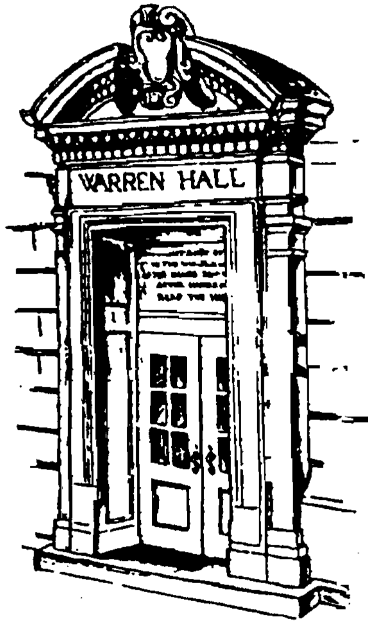
SP 97-06
September 1997



Staff Paper

Department of Agricultural, Resource, and Managerial Economics
Cornell University, Ithaca, New York 14853-7801 USA

Strategic Perspectives on Agricultural Finance

by

Eddy L. LaDue

It is the Policy of Cornell University actively to support equality of educational and employment opportunity. No person shall be denied admission to any educational program or activity or be denied employment on the basis of any legally prohibited discrimination involving, but not limited to, such factors as race, color, creed, religion, national or ethnic origin, sex, age or handicap. The University is committed to the maintenance of affirmative action programs which will assure the continuation of such equality of opportunity.

Strategic Perspectives on Agricultural Finance

by
Eddy L. LaDue[1]

What I am going to do in the next few minutes is discuss with you some ideas or thoughts that may influence the best strategy for First Pioneer Farm Credit during the next few years. You have been through major merger and reorganization activity during the past few years. The question at this time is what issues are important in designing strategy for the next few years.

My discussion is divided into three parts: (1) the customer, (2) the competition, and (3) the organization. For each topic, I provide a few ideas or thoughts about the issue and some implications for strategic planning.

The Customer

Tri-modal Agriculture

Agriculture is increasingly moving towards a bi-modal or tri-modal agriculture. Many people refer to it as a bi-modal agriculture because we are moving towards mostly small and large farms. I think that it is more instructive for lenders to look at it as a tri-modal agriculture. This allows us to talk about the middle sized farms, which are decreasing in importance, but have important credit needs, as well as the small and large farms.

Small and part time farms with sales under $50,000 (or $100,000). These farms are often referred to as lifestyle farms. The operators, and/or their spouses, usually have full-time or part-time nonfarm jobs. They usually already know, or do not want to know, that their operations are unprofitable. They want credit provided efficiently, without a lot of hassle. Credit requests are normally quite small.

Because these loans are small, the lender cannot afford to spend a lot of time on loan analysis. In depth analysis of the business is generally not all that useful because business income is not a major determinant of repayment ability. These loans can usually be based on assets and nonfarm income. In most cases the lender will be better off spending minimal resources on these loans. Substitution of a small amount of increased credit risk (loan losses) for a lot of loan officer time will benefit the lender.

Midsize farms (tweeners) with sales of $50,000 (or $100,000) to $250,000 (or $500,000). I am not sure exactly where the cut-off points between these groups should be. At least the numbers provided should give you some idea of the sizes to which I am

[1] Professor of Agricultural Finance, Cornell University. This paper was presented at the First Pioneer Director Planning Retreat, Cornell University, Ithaca, New York, August 26, 1997.

referring. For midsize farms, the farm generally provides most of the income for the family. Profitability of the business is important to the level of family income achieved, and, thus, analysis of the business is needed for loan analysis and is useful for the family. However, these loans are still too small for the loan officer to spend a great deal of time on analysis and servicing activities.

Somehow lenders must find ways to achieve loan servicing efficiencies. Efficiencies will be more difficult to achieve with this group than for the small farm group. Some ideas of the kinds of things that might be done include: (1) requiring the borrower to provide complete financial statements - that reconcile, maybe in return for a 1/4 or 1/2 percent interest rate reduction (2) multiyear approvals, (3) complete analysis only for high risks, expansions or unknown situations. There must be other, better, procedures for obtaining efficiencies.

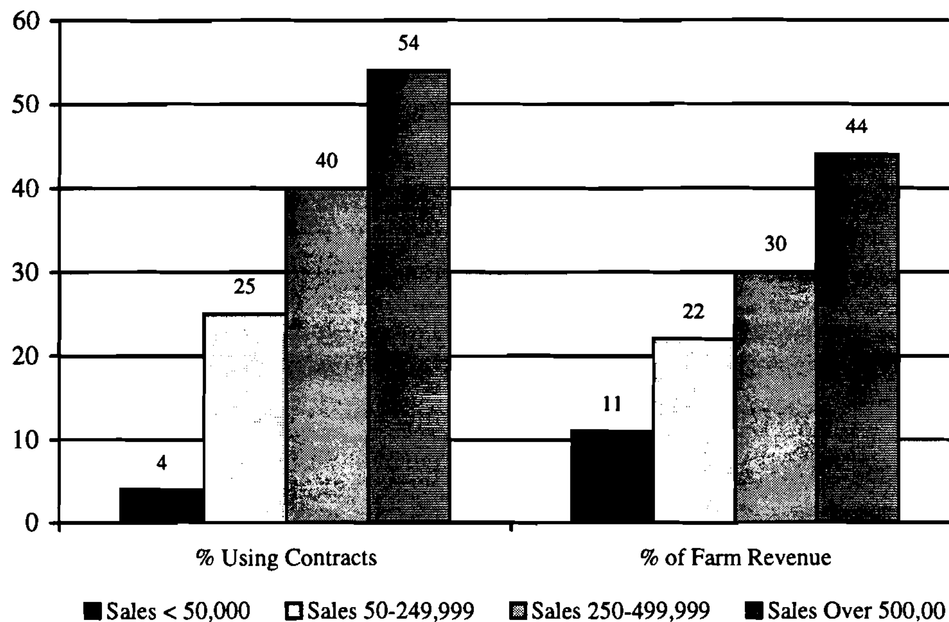
Large farms with sales over $250,000 (or $500,000). Lending decisions on these farms require complete financial analysis of the business, and providing that analysis can be profitable for the lender. Although competition for these loans will usually be strong, they are easiest to make profitable. The loans are large enough that even a small margin provides significant lender income. Owners of large farms are often rate sensitive and want loan products and services that fit their businesses. The biggest problem is that a mistake in lending to these borrowers will often be a **big** mistake.

The existence of a tri-modal agriculture means that lenders must have products and loan policy for each group. Equal is not efficient, profitable or equitable. Streamlined lending procedures, including such things as credit scoring and asset based lending, must be considered for the smaller farms. More efficient procedures must be developed for midsize farms. This may include some of the things done for small farms, but the needs of this group are sufficiently different that an alternate set of procedures and policies will likely be most effective. A full set of services and products can be profitable with large farms, but competition and interest rate sensitivity will likely be strongest for these farms.

Integrated Agriculture

Vertical integration and all kinds of contracting are moving agriculture to an integrated industry. Suppliers contract to control their market. Processors contract to control input quality and quantity. Farmers contract to secure markets, reduce risk, improve access to capital and improve production efficiency. As indicated in figure 1, contracting is becoming a very important part of production agriculture, particularly on large farms. Many farms are involved in contracting and a large proportion of U.S. agricultural products are produced on farms that are contracting.

Figure 1. Farm Use of Contracting in the United States



Source: David Harrington, USDA

The swine industry is rapidly moving to look like the poultry industry. The dairy industry will see more contracting to control quality and price. Biologically modified crops will frequently involve contracting to control use. The greenhouse/nursery industry has make wide use of marketing contracts.

Integration changes the risks involved in lending. The possibility of integrator or contractor failure adds an element of credit risk. In the past we have forced milk processors to be bonded so that farmers can be insured of being paid for milk that they ship. Most contractual arrangements do not have similar levels of protection for the farmer. If a contractor fails, a large part of a lender's portfolio can suddenly be in jeopardy. Short of failure, contractors and integrators may just fail to perform as expected. Nonperformance may reduce farm profitability and/or disrupt cash flow. Contract cancellation or nonrenewal can represent loss of a market which can devastate a business. Contracts are frequently shorter than the life of the buildings or machinery purchased to produce the product.

Clearly, integration represents another type of risk to add to weather, government and environmental risk that farmers and lenders already face. Lenders will need broader loan analysis skills in order to assess these risks. Loan officers will need to be able to evaluate integrator financial statements and contracts in order to identify the risks and design ways to control them. For most lending institutions this means a need for lender training and identification of benchmarking and other data of value in contractor assessment.

The increased prevalence of contracting may represent an opportunity to develop new loan products. I am not sure what those products should be, but such things as contract dependent loans, integrator guaranteed loans to farmers or loans through integrators to farmers may be useful.

Farmers as Deal Makers Rather than Asset Owners

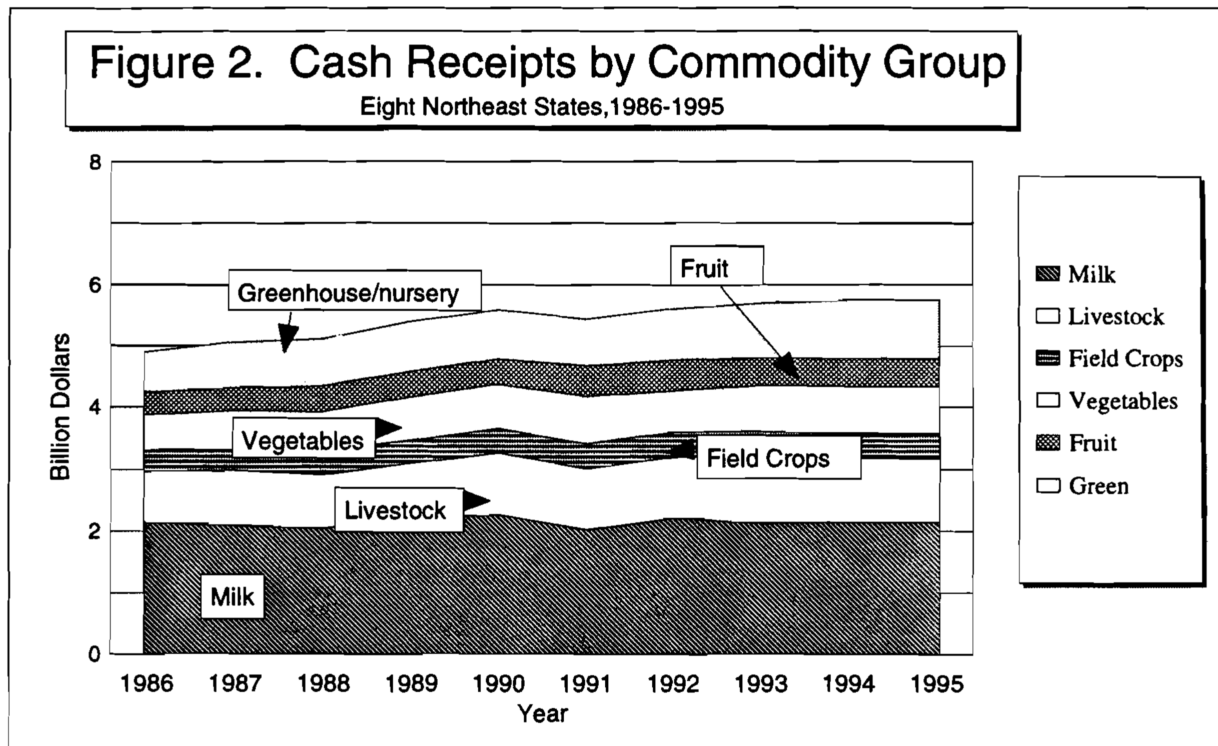
We used to identify a farmer as a person who owned a farm, or, at least, owned all the assets on a particular piece of farm real estate. That clear relationship is getting fuzzy. Farmers are leasing, renting, contracting more. Thus, a farmer becomes a person who puts together a set of resources to product an agricultural product. That person may rent or lease the real estate, lease the machinery, lease the livestock and contract for the purchase of other inputs and sale of the product. Commitment to a particular set of resources is reduced. The best deal wins. If a particular combination of resources or production of a particular product is unprofitable, the farmer exits from that activity.

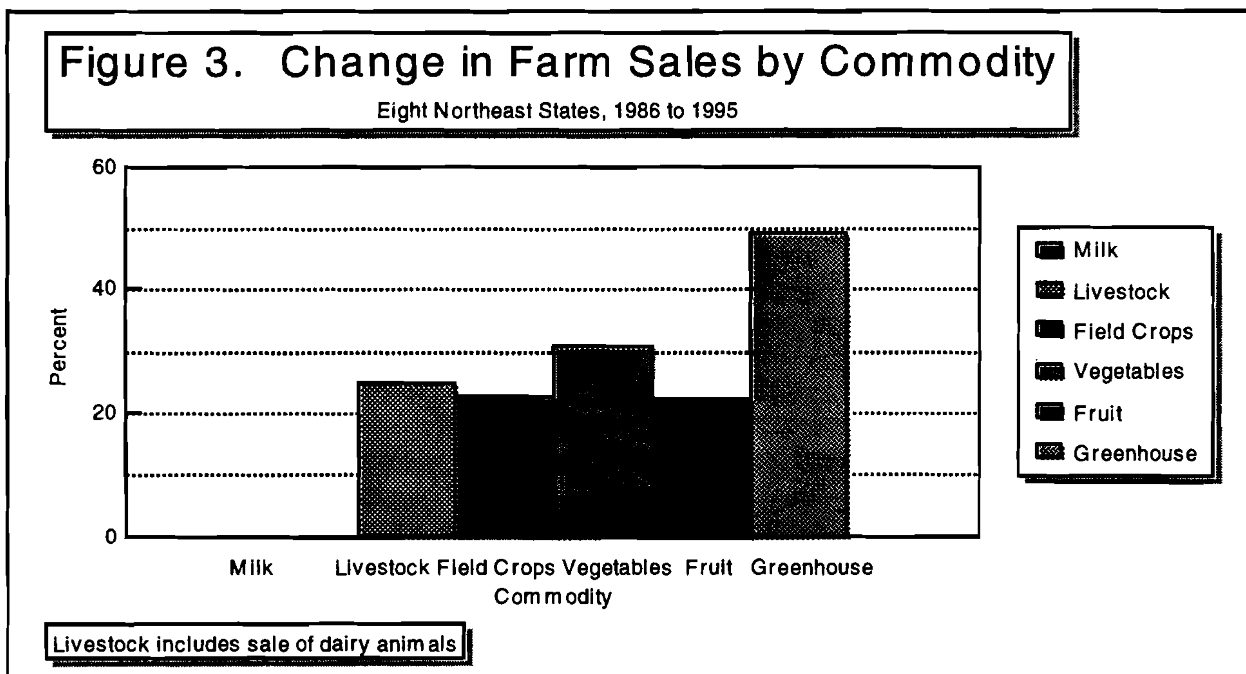
These deal makers represent different. and likely, higher credit risks than the more traditional farm owner. More focus must be placed on legal assessment of contracts and the interaction of contracts. Many of these farmers will be very interest rate sensitive. Renting money becomes another contract to negotiate for the best deal. Lending to this type of borrower will require intellectually nimble and well trained loan officers.

Commodity Focus

When strategically planning for the future, one of the important issues is whether you need to plan for a shift in commodity focus. When we look at cash receipts for the eight state northeast region (figure 2) we see only modest change in sales by commodity group. No commodity is disappearing or taking over in the region. If the future is anything like the past, there is little reason to expect major change.

Overall change during the last 10 years has been less than inflation for all commodities except the greenhouse/nursery industry (figure 3). The rate of inflation (as measured by the Consumer Price Index) totaled 39 percent over the 1986 through 1995 period. Thus, sales of any commodity group must exceed that rate of increase to have a real increase in sales during the period. Only the greenhouse/nursery industry, with an increase in sales in the eight Northeast states of nearly 50 percent, achieved a real increase in sales. The other commodities, except milk, increased in the 20 - 30 percent range. Milk would have had an increase in sales, if 1996, which had relatively high milk prices, had been the end year rather than 1995.

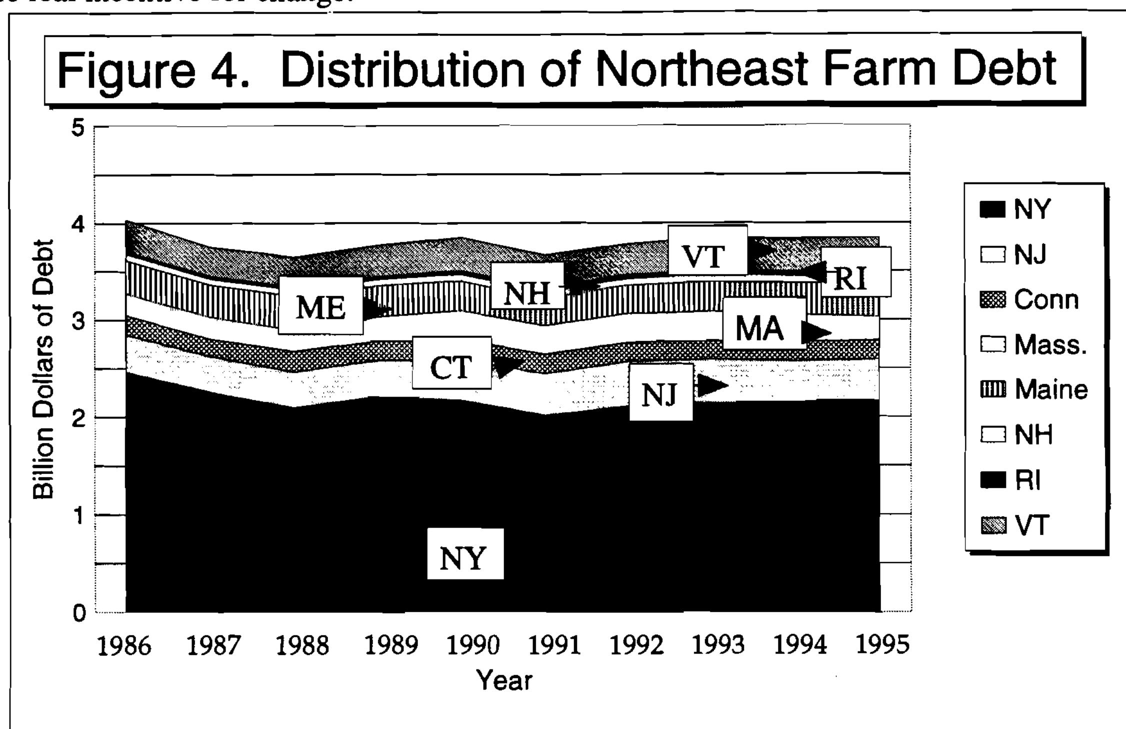




We often classify industries as being declining, mature or emerging. Under this classification, only the greenhouse/nursery industry could be considered an emerging industry in the Northeast. Thus, to serve important industries in the future you need to have greenhouse/nursery expertise and focused loan products.

Location

An important issue when thinking strategically is what is happening to the various segments of your market. If agriculture is moving into or out of any area, this could influence appropriate marketing and office location strategy. When we look at state level data, we do not find much evidence of movement within your market area (figure 4). Debt levels by states have not changed much during the last 10 years. Thus, this provides no real incentive for change.



A Bonafide Beginning Farmer Loan Program

I will contend that Farm Credit's beginning farmer program is little more than an accounting program. If a loan happens to be made to a young or beginning farmer, it is added to the total and reported. However, little in the way of accepting higher risk loans or offering better credit terms is provided. Loans to young and beginning farmers must meet all of the requirements that are used for other loans[2].

Making loans to beginning farmers has become more difficult since the farm recession of the 1980's. In their focus on avoidance of future loan portfolio problems like those experienced during the 1980's, regulators have come down very hard on any loan with significant risk. Young farmer loans are higher risk almost by definition. Thus, unless a lender is willing to set aside higher loan loss reserves for young farmer loans, they cannot be made. This has scared lenders from making loans to beginning farmers

[2] It was pointed out by a director in attendance that First Pioneer does have a special beginning farmer program the offers a modest rate concession and makes use of FSA guaranteed loan programs, but does not provide for a higher risk position to be taken by the lender.

and limited their willingness to take the risk on the promising young farmer who they might like to help.

However, without beginning farmer access to credit, the only new farmers to be added to the industry will be the sons and daughters of wealthy land owners, or just the wealthy. We could end up with the farming industry owned by the landed gentry. If you think that it is important for young people who are not necessarily the sons or daughters of rich farmers to get started in farming, a beginning farmer program is needed.

I encourage you to push towards a real beginning farmer program. Is a little higher loan loss reserve really to high a price to pay for a real beginning farmer program? One approach that might help would be to push for legislation to make FSA's beginning farmer program a program that lenders could effectively use.

Transfer of Large Farms

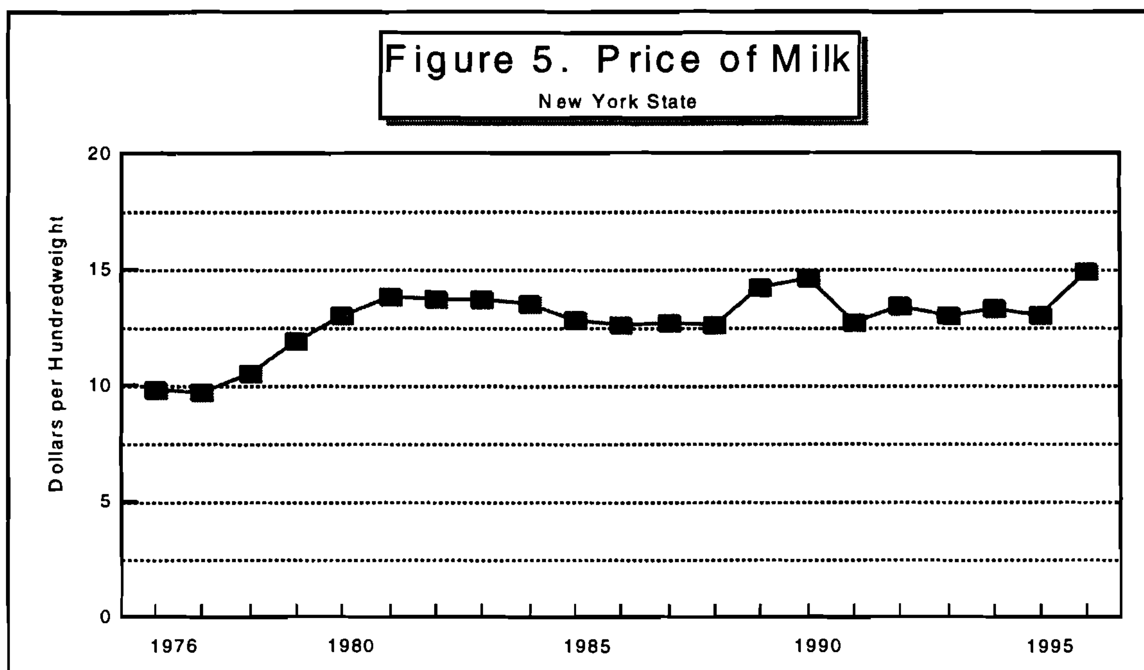
It is getting so that large farms have a **lot** of assets. Large farms keep getting larger and larger. Transferring these assets to the next generation is not a simple task, and we all have limited life spans! A host of issues, such as income taxes, estate taxes, financing, fairness to nonfarm heirs and management capabilities, make transfer a very complex issue.

These businesses need high quality middle managers to be really successful. The next generation will frequently be placed in these middle management positions and many will want ownership interest. To keep these middle mangers interested and to make them capable of being the next generation of managers, they will need training and we will have to find a way to give them ownership interest.

Intergenerational transfer of these farms represents a consulting opportunity that will expand. The entire transfer process will require assistance. You may want to consider development of innovative loan programs for middle managers. The insurance industry makes a lot of money on the transfer process. Is there a lending opportunity as well?

Increased Income Variability

There is going to be a high level of income variability for most of agriculture. Milk prices have become more variable since price supports became ineffective. If we look at milk prices over the last 20 years (figure 5) we see that milk prices experienced very smooth price movement until about 1989. At that time prices started to vary significantly. The support price is no longer an effective floor and there are not excess inventories setting around to be dumped on the market whenever the price starts to rise. In some years prices are good, other years they are bad. 1997 is turning out to be a "bad" year.



The new farm bill (FAIR) eliminates support programs for feed grains and wheat. This will allow prices to fall farther and rise further in response to market conditions, resulting in greater price variability. Historical variability in fruit, vegetable, greenhouse, nursery and livestock prices will continue. The fruit and vegetable producers response to the increased price variability experienced by dairy and grain farmers can be expressed as "welcome to the real world."

High variability in farm prices means high variability in repayment ability. Lenders and farmers are going to have to find ways to deal with fluctuation in farmers ability to meet debt payments. One approach will be increased use of futures markets and contracting. For most of the Northeast, this means that both farmers and lenders will need to increase their knowledge of the use and risks of futures and options. Hedged loan products may be useful. Another approach could be maintenance of a credit reserve that could be used in low price years and paid back in good price years. Effective use of a credit reserve would require that farmers and lenders explicitly incorporate the credit reserve in their planning and analysis procedures.

As lenders, you may want to give consideration to development of credit products that incorporate income variability. A structured variable repayment plan could be developed for some commodities. Such plans were the subject of considerable research several years ago. It may be time to give them further consideration. One of the real problems with income variability is how to keep the good year from generating a spending binge. There is a strong tendency for farmers to feel that a good price year represents "finally getting prices up where they ought to be" with the expectation that they will stay at this "normal" level. Thus, it is time to buy those things that they have wanted to buy for a long time. However, high price times should be used to get the financial house ready for the low price year that is not far ahead. You might want to

consider a “good year cash flow fund”, an advance payment fund or just encouraging advance payments.

One major result of the higher price variability will be an increased premium on good management. Good managers will be able to make money in this environment. Poor mangers will find that it exacerbates their problems and will use it as an excuse for nonperformance.

The Competition

Commercial Banks

The major happening in the banking industry in the past few years has been merger. Many banks have merged. I do not see this stopping for some time. Since the east and west coasts have been merging for several years, the continued merger will not result in a new banking environment in these regions. This is unlike the middle part of the country where merger is a new activity and a lot of changes will be taking place as they catch up with the rest of the country.

A major consequence of the merger activity is that as banks get larger management becomes further removed from agriculture. Agriculture becomes just another market segment to get into when financial conditions in the industry are good and get out of when times are bad. Thus, large banks tend to be faddish in agriculture, like they are in everything else. Decision making is based on the next quarter -- only. The Northeast has had some sterling examples of what happens in large banks. Fleet Bank basically killed off a $50 million agricultural loan portfolio. Key Bank management has had trouble deciding what it is going to do with its agricultural portfolio in good times, and has stirred the pot with great frequency. One of the results of merger is that ultimately some additional banks will effectively withdraw from agricultural lending.

Deregulation will likely expand the activities that are legal for banks. Expanded authorities in areas such as insurance, stocks and bonds will give banks other fish to fry. This will increase the focus on fee income, making any lending program less important to total bank profit. If this has any effect on agriculture, it will be to increase banks faddishness.

However, there are and will continue to be pockets of strong bank lending. There are several midsize banks (we do not have many small banks in the Northeast, at least by national standards of what is small) with a commitment to agriculture who do a very good job and will continue to do a good job -- as long as they are not merged. These banks hire good agricultural lenders and stay in agricultural lending through good times and bad. The Community Bank experiment (a large bank that focuses on rural areas) will be worth watching and could be come an important (more important?) competitor in agricultural lending.

Banks major advantages compared to Farm Credit are their ability to offer a full range of financial services and the lack of a stock requirement. Banks offer checking accounts, trust services, safe deposit boxes, savings accounts for the children, currency exchange and other financial services that Farm Credit does not. The old Empire Association had gotten the stock requirement down to where it was almost unimportant for most situations. However, current stock requirements are important.

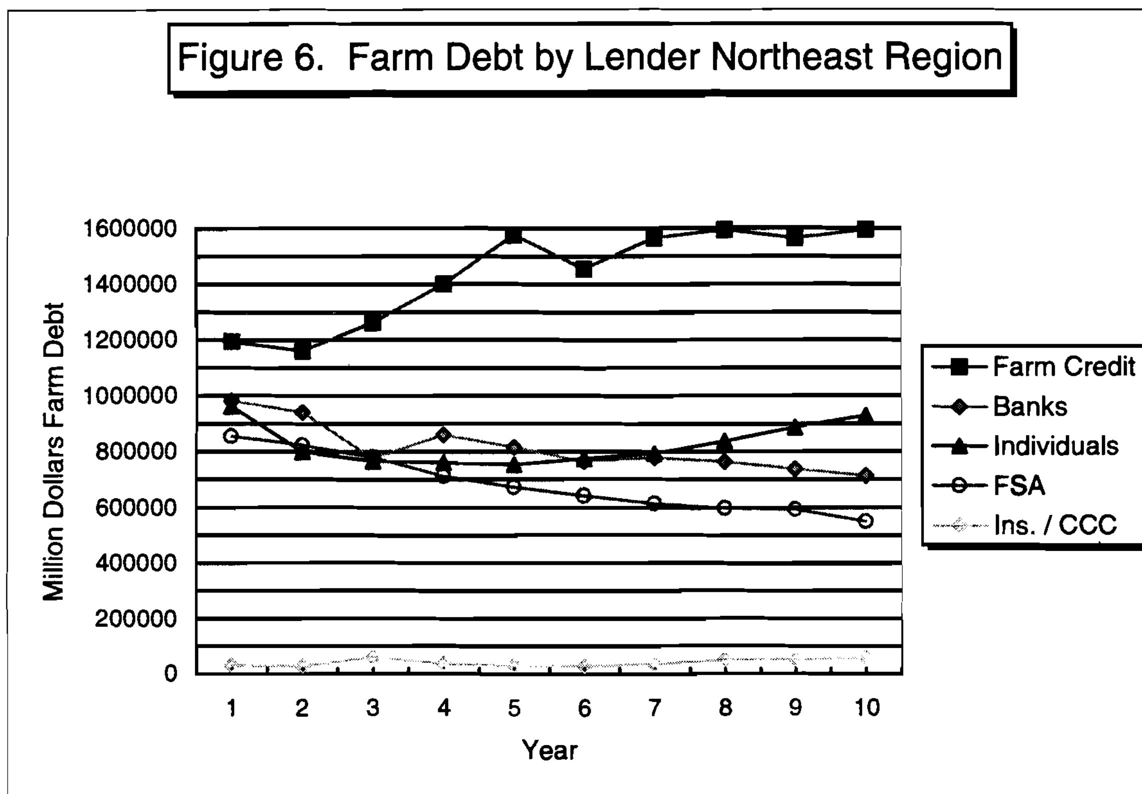
What does this mean for First Pioneer? Opportunities will occur when banks merge or the current fad is to de-emphasize agriculture. You need to be prepared. You might want to consider a formal competition surveillance program. This is a two edged sword, however. Farm Credit also tends to be faddish. The vacillation comes from shifting focus from "loan volume" to "loan quality" and back. Although part of this may be regulator driven, much comes from too little focus on quality during "loan volume" periods and too single mindedly focusing on quality during "loan quality" periods. An effort to avoid "hot" and "cold" lending could help your long run competitive position.

There will also be geographical differences in loan volume performance depending on local competition. Market penetration will be much more difficult in some areas than others. Expected performance should take into consideration the level of competition in the region. This is really nothing new, of course, since it already exists in your market area. Banks have effectively withdrawn from some areas of the Northeast, but are effective compeition in other areas.

Nontraditional Lenders

The strongest competition in the near future will come from nontraditional lenders! Machinery manufacturers, feed companies and other input suppliers have found that providing credit can be profitable. Interest **and** product margins depend on the loan decision, resulting in the provision of credit in some cases where traditional lenders would hesitate. Estimates of the effect of providing credit indicate that as high as 20 percent of credit sales may represent added business. Processors are providing credit to insure or control product supplies.

Loan volume, during the last five years, in the Northeast (figure 6) indicates that Farm Credit volume has been relatively constant, and bank and FSA volumes have declined, while individual and merchant credit has increased. The increased importance of nontraditional lenders is already evident.



Nontraditional lenders have fewer regulatory restrictions. They have no regulator looking over their back. They have no limiting charter telling them what they can and cannot do. They have no required reserve balances like those that depository institutions must maintain. They have no capital requirements except those established by their parent company. This freer environment is less costly and less limiting.

Nontraditional lenders also do not have the rather stogy inhibitions that are often endemic to traditional financial institutions. They feel free to be innovative and do what ever makes money. For example, a New Zealand input supply firm has been very successful with a credit card, for purchases from their firm and other suppliers.

To compete with the nontraditional lenders, Farm Credit and commercial banks will need to meet them at the market place where ever they can. They will need to be innovative in the development of new products. One of the real advantages of dealer credit is convenience. You need to make credit convenient. A farmer sitting on a new tractor at the John Deere dealership wants to drive it home. The dealer says "just sign here and drive away." Traditional lenders must find ways to be as convenient. Possibilities include credit cards or loan checks.

Credit scoring for new borrowers and preapproved lines of credit for existing borrowers may represent tools that can also be used to compete. You do, however, need to recognize your shortcomings. It will be very hard for a traditional lender to compete with John Deere's repossession capability. They have the capability to go get, and start it

if necessary, the machine that is being repossed. They can market it in a normal fashion; they do not have to auction it on the courthouse steps.

Farm Service Agency

The Farm Service Agency will likely be minimally important in direct lending in the near future. Congress and the administration have been pushing for a reduced direct government lending role. For the most part, I think this is appropriate. Decisions involving judgment are difficult for the government regardless of the quality of the lending staff.

The guarantee program, on the other hand, is likely to continue. The program may change over time as the government tries to find ways to effectively conduct national credit policy through guarantees, but it is likely to be around. I know that some of you are not convinced that such subsidized credit should exist, but it does. The only rational thing for lenders to do is take advantage of it as a cheap credit risk reduction program.

Differentiation from the Competition

As you think strategically about where you want to be relative to the competition, you may want to consider how you want to differentiate yourself from that competition. There are basically five different ways to accomplish that differentiation. You may want to think about your position relative to each of these methods, or you may choose to focus only on one or a few.

1. Price differentiation. This would usually involve being the lowest price lender in town and often requires maintaining low costs and high volume.
2. Image differentiation. The image you foster needs to be something the will appeal to most of your preferred customers. Examples would include farmer owned, member owned and operated under cooperative principles.
3. Support differentiation. This involves an image that the lender provides a range of services or provides all the services that the borrower will ever need. Provision of a full range of financially related services with high levels of agricultural expertise or full service banking are examples.
4. Innovation differentiation. This is for the lender who aggressively embraces development of new products and services. Examples, include an image that new products are always being developed for new situations or that the lender is always ahead of the competition.
5. Competition differentiation. We will "meet or beat" any deal. This usually requires having the flexibility to design products, services and deals in ways that will do at least as well for the customer as any competitor can offer.

As you think about your strategy, you should decide what image you want to portray to potential customers. That is, identify which image will separate you the most and most positively from the competition.

The Organization

Make being a loan officer a good job.

During the last few years, all lenders have increased their efficiency on the backs of loan officers. Down sizing, right sizing and many other titles were used to reduce the number of loan officers. If you have two loan officers and you fire one of them and tell the other to handle the portfolio, you have increased efficiency! All lenders have done this to some degree. I will have to say that Farm Credit did its downsizing and reorganization with less human pain than most banks. Banks have this tendency to meet people at the door in the morning, tell them they are fired and are to have their desk cleaned out by noon when they will be escorted off the premises. I heard no complaints about the way people were handled by Springfield Farm Credit.

Few new loan officers are "really excited" about their jobs. When asked, they characterize their jobs with such comments as: learning a lot, much responsibility, good mentor and long hours. They do not say: I enjoy my work, it is a good place to work, I am learning to help farmers finance their businesses. Now, I admit that people in their first job are frequently reserved. They just left the idyllic college environment, where considerable time was set aside for non-work activities, to enter the real world. However, there has been a lot less excitement from loan officers during the last few years than was normal in earlier times.

You have reorganized the offices. Now is time to reorganize the workload. Total hours need to get to a more reasonable range. No one expects to get a good paying job and work only 40 hours a week. However, forcing work loads that require 60 or 70 hours per week is pushing it. You need to use the "tools" and loan policy to increase work efficiency. Loan documentation and face time must be tailored to the risks.

This would also be a good time to invest in some employee morale. Spend some time and money in developing some esprit de corps. Job turnover rates depend on it.

Continue focus on high quality work force

The Springfield district has a long history of hiring the best. Certainly, the high quality of the work force contributed to the success of the Northeast Farm Credit compared to Farm Credit in the rest of the U.S. during the last 10 years. It was not the only factor, but it was important. You need to continue to hire the best. Do not join some lenders in the midwest who are known to hire from the bottom half of the class. Such "bottom feeders" will continue to have low loan volume and poor credit quality.

I also encourage you to continue your strong training focus. The training you have provided has been very high quality and effective. It will be even more important in the future as fewer of your new employees will have **both** the background and training that you would like. The only criticism I would have of your training is that it tends to be very

in-house, and thus, somewhat inbred. You might want to consider broadening the exposure, particularly for the more advanced training experiences.

Finally, you will have to be willing to pay for quality. The very top of the class is being hired by other agribusiness firms, who may soon be part of the competition. Do not let yourself get too far down on the quality scale.

Financially Related Services

There are a number of reasons why financially related services represent good business for Farm Credit in the future. First, multiple relationships increase customer loyalty. If a farmer is doing three or four things with you, only one of which is borrowing money, he or she is much less likely to switch to a different lender for a few basis points on the interest rate. Financially related services provide an opportunity to significantly increase the number of relationships.

At least in New York, county level Cooperative Extension for agriculture is a "dying duck". Tax reductions at the state and federal level have forced a higher level of funding for mandatory programs at the county level. Discretionary programs, such as Cooperative Extension, get lower levels of funding. Agriculture takes a big hit because it is viewed as helping people who do not necessarily need subsidized help. Some of the programs that Extension has historically conducted could be carried out on commercial basis.

Larger farms are starting to recognize the need for a management team, part of which should be from outside the farm. Consultants and records specialists are logical parts of these teams.

Few other providers of many services that farmers use have proven agricultural expertise. Finding an attorney who knows something about agriculture and farm businesses is difficult. Appropriate transfer of farm businesses frequently requires an analyst or planner who is familiar with the characteristics of farm assets and businesses.

Farm Credit in the Northeast has proven that at least some financially related services can be conducted on a profitable basis. Further, these services can be expanded without new loan authorities. It does not take an act of Congress to add a new one.

Clearly, the focus on financially related services should continue and you should look for new opportunities. A couple of possibilities would be to provide an attorney for estate and transfer planning and provision of a management information system rather than a financial record keeping system.

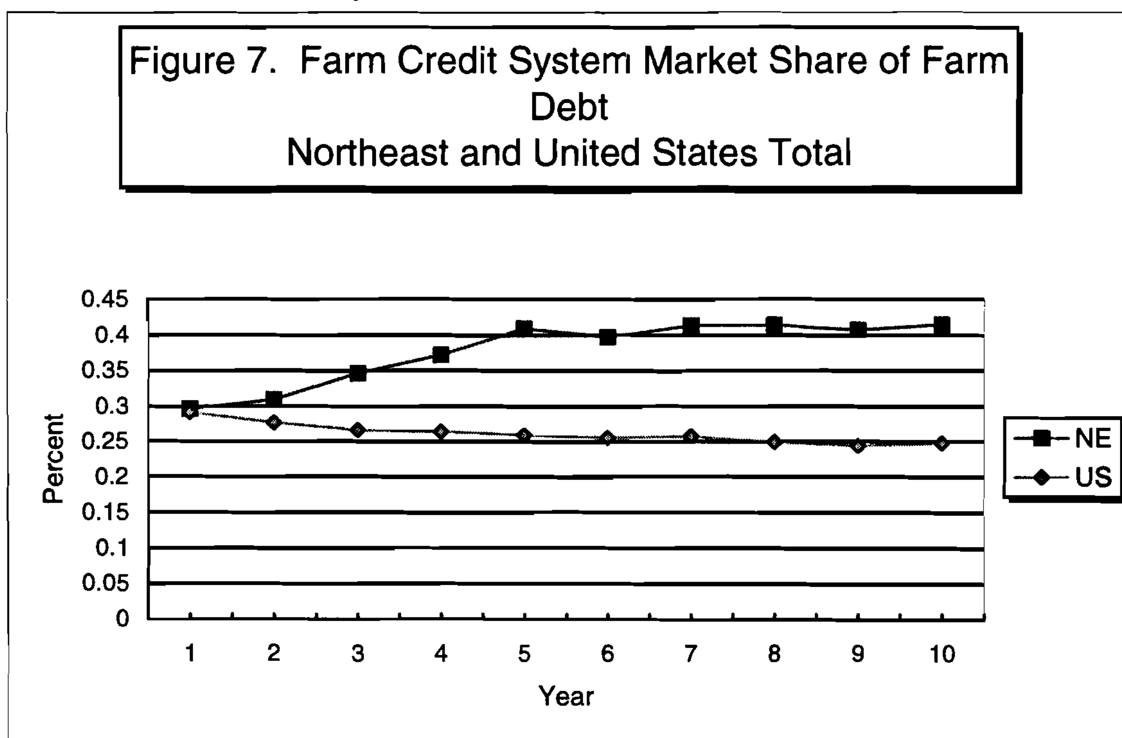
Expand Geographically

Every institution must search for its optimal size, which changes over time. Since First Pioneer is the fourth largest ACA in the nation, the need to expand at this point in time must be limited. Additional economies with expanded size will be small. You might be able to achieve some economies but they will be modest compared to the cost level you can achieve at your current size run efficiently.

First Pioneer has been through considerable expansion and consolidation during the past few years. You may even be sick of the process. Thus, you could be justified in saying "been there, done that, lets look at other issues." If you look at the contiguous areas to First Pioneer, it is doubtful if you would gain much by merging with the rest of the Northeast Associations. Yankee and Maine likely need you more than you need them. You would gain only relatively modest capital and little diversity. Western New York would add some good agriculture and some capital, but little diversity. Merging with part of Pennsylvania, however, could add diversity. You could add hogs, beef cattle and mushrooms.

Expand Product Lines

Farm Credit's market share in the Northeast is quite high, particularly compared to the market share in the entire U.S. (figure 7). Thus, expansion opportunities are limited. Although some increases are possible, and likely will occur, a major push to increase share could be risky.



A major problem that Farm Credit faces is the risk involved in being a single industry lender. Problems for the agricultural industry mean problems for Farm Credit. However, if the insurance fund level is set correctly, FCS should be able to handle any industry risk with the insurance fund and capital. Thus, industry risk is not something that should bring FCS to its knees.

Industry risk might be reduced by moving into other areas of rural lending. Expansion of authorities requires legislation. To get expansion of authorities to make nonfarm rural loans at the national level would likely require giving up GSE status or somehow giving effective GSE status to commercial banks. Even then legislation could take a long time and considerable effort. Breaking away from the System to become a separate financial cooperative will require giving considerable capital (including your investment in the insurance fund) to the System and being subject to a yet to be determined set of lender requirements, even if you continue to borrow from CoBank. Clearly, getting expanded authorities will not be easy.

Expanding into rural nonfarm loans could be risky itself. I am not convinced that there are a lot of good loans in rural areas that are not being made. Most of those projects that cannot get funding are in that position because the project has cash flow deficiencies, high risk characteristics or other problems. Thus, the rationale for Farm Credit moving into nonfarm rural lending is not the unavailability of funds, but the need for better competition. Farm Credit would be a strong competitor and likely could, in time, get considerable rural loan volume. A few loans would be made in rural areas that would not be made otherwise. The risks that Farm Credit could face would be (1) the lower quality portfolio of a new lender in the market who will get a higher proportion of the marginal loans, and (2) the losses that would likely occur with a largely inexperienced loan officer staff. You need only think back to the first loans made to the fishing industry to get some idea of the problems involved. Obviously, a major training effort would be required.

Another possible problem with a major expansion of authorities is the possibility that a Farm Credit entity with lots of other places in the rural countryside to put its funds would decide to become faddish about agriculture, like the other people (banks and insurance companies) with lots of other alternatives. I think it is possible to make a case that Farm Credit should be limited to agriculture because that will insure that they stay focused on agriculture and guarantee continued funding to agriculture. Certainly faddish agricultural lending is not necessarily a problem. Moving into rural loans does not have to reduce the commitment to agriculture. The other advantages might out weigh this potential risk. But, it is something that farmer directors should think about.

Consider Farmer Mac

When you look at historical interest rates and the level at which they are now setting, one must conclude that the probabilities that interest rates will be considerable higher in the near future are much higher than the probabilities that they will be constant or lower. Current low rates are unlikely to last forever. At the same time farm prices are

not so high but what some farmers could have trouble making their payments at much higher interest rates. Many of those farmers could benefit from some fixed rate funding of their business. Availability of 10 or 15 year fixed rate loans could be important to their ultimate success.

If Farm Credit makes such 10 or 15 year fixed rate loans, it currently must rely on asset/liability management to handle the risk. However, asset/liability management can only reduce the risk. Making fixed rate loans without any securitization will increase interest rate risk of the institution.

One obvious solution to this problem is to make use of Farmer Mac. The securitization process passes the interest rate risk on the investor. Farm Credit is able to offer its customers better service without added risk to the institution. Use of this tool should be given careful consideration.

Conclusion

The future of your organization depends on the quality of your strategic planning. I hope I have given you at least a couple of ideas that will help you in that process. Good luck, and thank you.

OTHER A.R.M.E. STAFF PAPERS

SP No	Title	Author(s)
97-05	The New York State Hispanic Population: A Description and Evaluation of the Mexican Descent Group	Figueroa, E.E.
97-04	Assessing the Implications of IPR on Plant and Animal Agriculture	Lesser, W.
97-03	Transforming Agriculture and the National Economy in Taiwan: Lee Teng-hui and the Joint Commission on Rural Reconstruction (JCRR)	Wilde, P.
97-02	Extra-Market Values and Conflicting Agricultural Environmental Policies	Poe, G.L.
97-01	Delivering Assistance to U.S. Agricultural Exporters: Observations from the Front Lines	Jenni, J.K.
96-07	Farm-Retail Price Spreads in a Changing Economy	Tomek, W.G.
96-06	U.S. Dairy Sector Simulator: A Spatially Disaggregated Model of the U.S. Dairy Industry	Pratt, J., A. Novakovic, M. Stephenson, P. Bishop and E. Erba
96-05	Agricultural and Farmland Protection Planning: A Case Study in Orange County, New York	Joyce, L.T. and N.L. Bills
96-04	International Treaties and Other Legal and Economic Issues Relating to the Ownership and use of Genetic Resources	Lesser, W.
96-03	The Competitiveness of Mexican and Caribbean Basin Horticultural Products in the U.S. Market	Figueroa, E.E.
96-02	The Effects of Increased Trade on the U.S. Fruit Sector	Figueroa, E.E.
96-01	Farmland Preservation: Agricltural Districts, Right-to-Farm Laws and Related Legislation	Bills, N.
95-13	Regional Impact of Change in Dairy Trade Policies on the Northeast U.S. and Central Canada Dairy Sectors	Doyon, M.A., J.E. Pratt and A.M. Novakovic
95-12	Tax Traps and Opportunities Associated with Family Farm Transfers	Smith, S.F.
95-12a	Future of the Grape Industry: An Eastern Perspective	White, G.B.
95-11	Intellectual Property Protection for Indonesia	Lesser, W.

To order single copies of ARME publications, write to: Publications, Department of Agricultural, Resource, and Managerial Economics, Warren Hall, Cornell University, Ithaca, NY 14853-7801.