Policy options for agriculture

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Many farmers currently face severe financial stress resulting in asset liquidations, problems in obtaining credit, and even bankruptcy. An important issue in policy analysis is the applicability of traditional farm policy approaches to the current situation. This is a particularly relevant issue because the 1983 Payment in Kind (PIK) program was one of the largest and most expensive government transfer programs for agriculture in recent history, and yet many farms are still facing severe financial problems. Financial management strategies and enhanced farm and off-farm income can relieve the stress for some farms, but those with high leverage ratios (for example, 70 percent or greater) will likely not be able to obtain sufficient relief from various financial and farm management strategies to stave off asset liquidation or default. Adjustment to a new financial and economic environment may require government assistance.

Much of the past public assistance to farmers in financial stress has been in the form of price and income supports. Such a policy response may not only be an extremely high-cost alternative, but if improperly implemented, might result in disincentives to adjust resource use in agriculture to the slower growth in demand for its products. Most analysts believe that agriculture must adjust to its excess production capacity and lower values for some agricultural resources, particularly land. If this is the case, then a public policy that impedes that adjustment will not only be very costly, but may result in long-term dependence on government assistance, as well as continued government interference.

While higher incomes would contribute to a healthier agricultural sector, the current financial stress problem in agriculture is too complex to be relieved solely by improved income. In fact, most agricultural support will go to large farms, whereas farms of all sizes are exhibiting stress. Other means for enhancing the income of agriculture, through subsidizing and promoting exports, devaluing the dollar, expanding domestic consumption including bio-mass production and fuel use, and converting grainland to grassland also only focus on one dimension of today’s financial crisis in agriculture. A broader perspective and a broader set of policies is required to solve today’s “farm problem.”

Given the financial stress faced by the agricultural sector, the appropriate policy response is a relevant question. In order to evaluate alternative policy options, selected policy options can be quantitatively analyzed using microeconomic simulation models (see Box). The results from this process lead to the conclusion that measures other than the traditional farm income and price support programs may provide a greater chance of survival for financially troubled farms.

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Bankruptcy. Public policy currently encompasses a set of rules to resolve severe financial stress problems—the bankruptcy rules. Although bankruptcy may involve immediate liquidation of the assets and a discharge of farm debt, it can also involve restructuring and rehabilitating the business under Chapters 11 or 13 of the bankruptcy law. Farmers cannot be forced into an involuntary bankruptcy. A farmer who chooses Chapter 11 (or possibly Chapter 13) bankruptcy proceedings becomes a “debtor in possession.” Generally the farmer continues to manage and operate the farm, possibly under the surveillance of a creditors’ committee. A trustee to manage the property is appointed only in rare cases, so the farmer can continue to operate the farm as long as he follows an acceptable debt reduction plan.

The bankruptcy rules specify how the private sector will share financial losses in case of a default by a creditor, but two fundamental issues remain. First, should the private sector—the creditor, the debtor, and others who

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have done or are doing business with the debtor absorb the full loss, or should the public sector share part of this loss through some type of government transfer payment program? And second, and probably more important, who in the private sector under the current provisions should typically be required to absorb the majority of the loss? Because of the extensive use of merchant and dealer credit, the bankruptcy rules likely transfer the major losses from the production sector and the lending institutions to the input supply firms, which are only involved peripherally in financial management decisions. A fundamental question can be raised as to the equitability of this sharing of the financial losses due to debtor default.

**Debt moratorium** is a second, rather blunt policy instrument that might be used to respond to the current financial stress in agriculture. This alternative would deny the use of foreclosure procedures against farmers who cannot make their principal and interest payments, cancel or defer interest and principal payments for a specified time, write down a portion or all of the debt, deny deficiency judgments for those who cannot make their payments, or combinations of the above. Most debt moratorium proposals include a limited period in which debt obligations need not be met, but they do not eliminate the commitment to repay debt. Consequently, a key to the success of such proposals is that the financial condition of the firm and the industry will improve sufficiently in the intervening period so that the obligations can be repaid. Debt moratoriums were used with limited success in the 1930s to relieve the financial pressure faced by farmers.

The major direct cost of a debt moratorium is the income foregone by the lenders during the moratorium period. But in addition to this cost, there is serious concern about the implications of such programs on the long-run performance of the financial markets. Lenders who feel their earnings flow may be interrupted by future moratoriums will likely judge that there is more financial risk in credit extension and would expect to be compensated for that risk through higher rates of interest. Furthermore, some borrowers would no longer be able to obtain credit even if they have adequate collateral because a debt moratorium has negated the value of collateral in the credit extension decision.

**Loan guarantees.** Another possible public policy response is the provision of loan guarantees from a federal or state agency to indemnify the lending institution from default on the part of a borrower. Such a program is currently available from the Farmers Home Administration and additional funding could be made available for this program. To be an effective solution, a loan guarantee program must be combined with other alternatives such as systematic asset or liability restructuring to reduce the debt obligation or increase the cash flow of the business. Properly structured, a loan guarantee program may provide the time necessary to implement more permanent solutions and to protect the resource markets from collapsing in the process. Without a long-term solution, a loan guarantee program might be perceived as simply a “lender bailout.” A variation of the loan guarantee program would offer the lender a federal or state bond in exchange for the loan; such a program transfers the responsibility for collection, as well as the debt obligation, to the government, and quite likely would result in higher cost than the traditional Farmers Home Administration, Small Business Administration, or other government guarantee.

**Debt restructuring.** A proposal that has received widespread attention recently is that of federally assisted debt restructuring. In fact, most of the current legislative proposals are variations of the debt restructuring theme. The premise of this approach is that providing additional time to repay the principal would reduce annual obligations, thus enabling some farmers to cover their lower principal and interest payments. For those who still cannot meet their debt obligations, restructuring would provide additional time to rearrange the financial structure of their businesses, including possibly the sale of assets. Most restructuring proposals involve the potential of a write-down of the debt as a condition to obtaining a federal or state guarantee. For many producers who are facing financial stress, such a program may not be a permanent solution, but the first step in a long-run plan to adjust the asset and liability structure of the business so that the firm can survive.