

**Committee on Agriculture  
United States House of Representatives**

**Hearing on  
U.S. Farm Policy and the 2012 Farm Bill**

**Testimony of**

**Paul N. Ellinger, PhD  
Head and Professor, University of Illinois  
Department of Agricultural and Consumer Economics**

**May 13, 2010**

Good morning, Chairman, Committee Members, and observers. My name is Paul Ellinger and I am a professor and head of the Department of Agricultural and Consumer Economics at the University of Illinois at Urbana Champaign.

I am pleased the committee is conducting these hearings to help set the stage for next farm bill. My understanding is that my primary role today is to provide background and expertise regarding the finance and credit issues facing agriculture and rural America. I would also like to discuss briefly the changing landscape for research, education and extension. The current budget crisis has significantly challenged our academic institutions. We are at a critical crossroad as land-grant institutions incur significant declines in funding and investments needed to lead discovery and innovation for a competitive and efficient food and agricultural system.

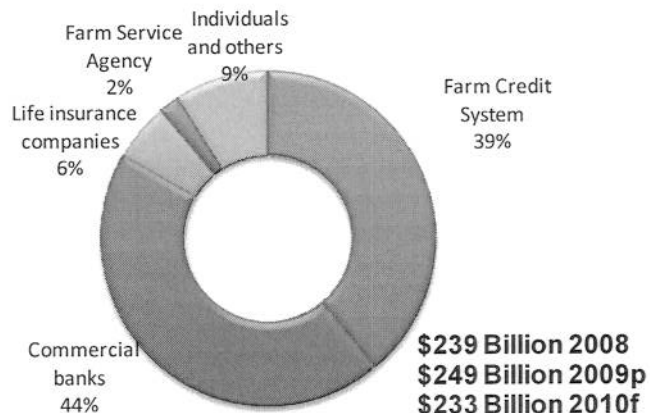
**Current Credit Landscape in Agriculture**

Financial markets and institutions are coming through unprecedented and well-documented disruption. Production agriculture has not been immune to the crisis. The direct impact of the credit crisis impacted global economic growth that subsequently contracted aggregate demand for agricultural commodities.

In comparison with other sectors of the economy, agriculture is generally characterized as using a low amount of debt relative to assets. The U.S. Department of Agriculture estimates total farm debt of approximately \$233 billion at the end of 2010. Total assets in the farm sector are forecast at \$1.876 trillion resulting in a farm aggregate debt-to-asset ratio of only 12.4%. The aggregate debt numbers often mask the wide disparity of debt usage among farms. Larger farms with higher revenues tend to rely more heavily on debt than smaller farms.

The primary lenders in agriculture are commercial banks, the Farm Credit System, life insurance companies, Farm Service Agency, and captive finance companies. The Farm Credit System holds approximately 38% of the total farm debt while commercial banks hold 44%.

**Total Farm Debt Shares:  
2008**



Source: Economic Research Service

Commercial banks lending to agriculture can be further divided into three general segments -- small, community banks, regional banks and larger money-center banks. Over 78% of the loan volume and over 98% of the banks lending to agriculture are from banks with less than \$10 billion in assets.

Commercial Banks Lending to Agriculture

Asset Size	Percent of Ag Loans at Commerical Banks	Number of Banks
Less than \$100	14%	2,241
\$ 100 to 500	35%	2,728
\$ 500 to 1,000	11%	479
\$1,000 to 10,000	17%	360
Greater than \$10,000	22%	63

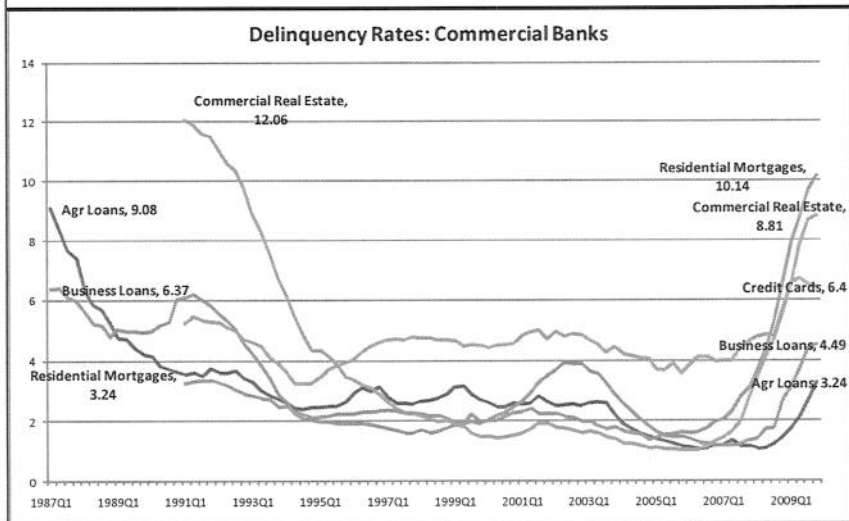
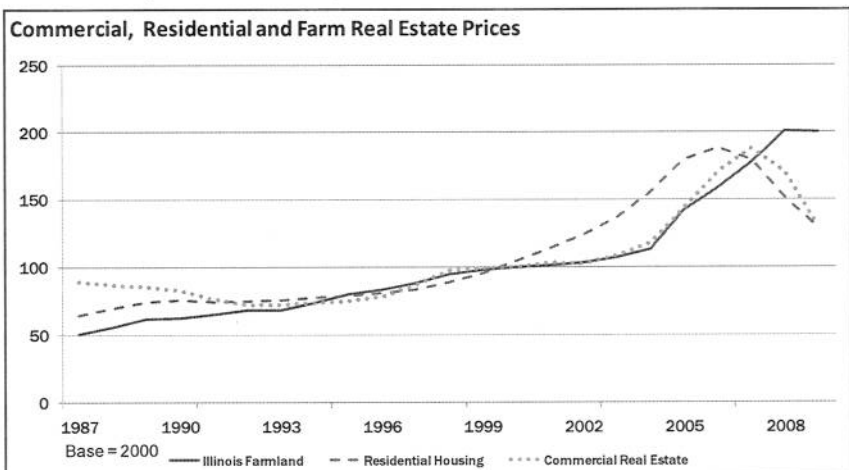
Source: Call and Income Reports 12/31/2009

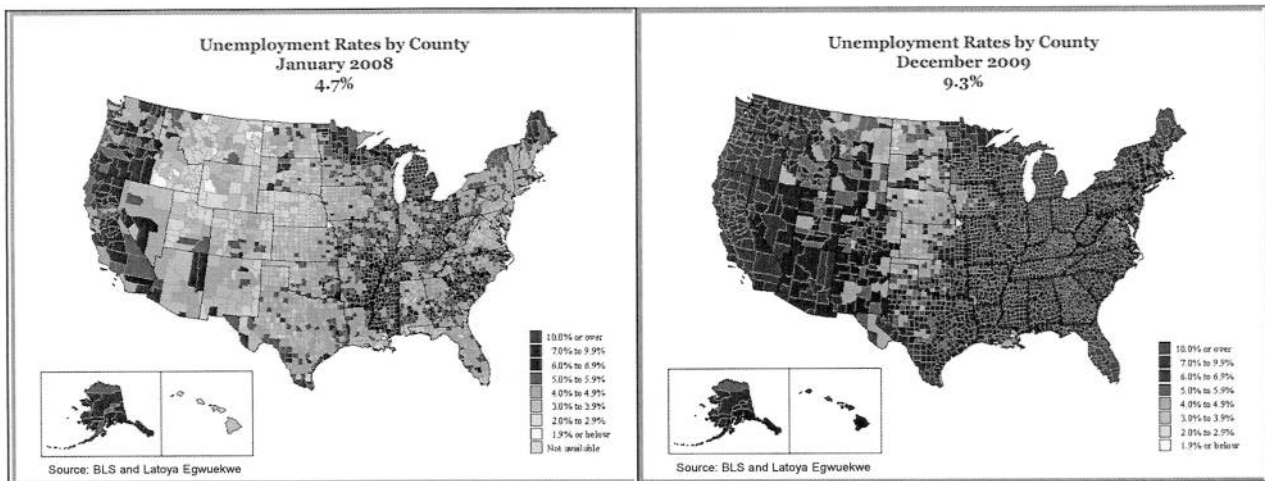
Approximately, 18% of the banks lending money to agriculture are publicly traded or owned by a publicly traded bank holding company.

**Impacts of Financial Crisis on Lending Institutions to Agriculture**

Relative to other financial intermediaries, agricultural lenders generally remain healthy. Many of the agricultural-related institutions did not participate in higher-risk housing lending procedures nor were they significantly invested in the structured securities that lost substantial market value. The initial impact of the crisis did impact larger agribusinesses through lack of working capital financing or trade credit and the large increase in the cost of debt capital. The initial phase of the financial crisis did not have a pronounced effect on the credit availability to much of commercial agriculture, but did impact the securities portfolios of many lenders providing credit to agriculture. Agricultural lenders have also benefitted from strong sector income in 2007-08. Moreover, farm real estate valuations have not experienced the steep declines in residential and commercial real estate prices.

Delinquency rates of agricultural loans at commercial banks and the Farm Credit System have increased, but remain lower than other economic sectors. The key stress sectors in the portfolios of agricultural lenders are dairy, pork, poultry, ethanol, and timber. Increased unemployment in rural areas has impacted debt repayment capacity of many rural farm borrowers.





Widespread banks failures in 2009 resulted in the FDIC imposing an additional assessment to banks for prepayment of three years of premiums. Of the 205 commercial bank failures in the U.S. from January 1, 2009 through May 7, 2010, only 134 failed banks held agricultural loans and represented only 1.41% of the volume of agricultural loans held by commercial banks. The more than 700 banks estimated to be on the FDIC watch list hold only 4.5% of commercial bank agricultural loans. Challenges facing rural community banks include continued stress in the commercial and residential real estate loans sectors, prolonged unemployment in rural areas, increased vulnerability to interest rate risk, and reduced profit margins resulting from the substantial increase in the FDIC assessment in 2009.

The Farm Credit System has also experienced stress in their portfolio, but remains healthy as a result of a strong capital position. Nonperforming loans were 2.14% of total loans at year-end 2009. Farmer Mac, the GSE which serves as the secondary market for agricultural loans, suffered substantial capital losses due to investments in Fannie Mae, Freddie Mac, Lehman Brothers, and similar securities. As a result of their exposure to these positions, they issued preferred stock to increase their capital ratio. In early 2010, the capital was paid back in full and now Farmer Mac has the largest capital surplus in its history. Authority to allow rural-utility loans to be considered as Farmer Mac “qualified loans” in the 2008 Farm Bill has provided needed funding for rural-infrastructure as well as a strong portfolio segment for Farmer Mac.

The asset-backed-security market was also crippled by the initial crisis. Asset backed securities are used by some farm machinery companies such as John Deere and Case New Holland as a cost-effective method to fund loans to borrowers. Since this alternative was not available, some companies had to use higher cost methods to finance these loans. The Term Asset-Backed Securities Loan Facility (TALF) helped revive the ABS market and provide additional funding opportunities for farm machinery companies to extend credit to farmers.

In summary, despite a very turbulent economy, agricultural lenders continue to lend to agriculture. Moreover, even as credit standards tighten, many institutions have taken on new agricultural loans.

#### **Credit Related Agriculture Policy Issues**

Continued credit availability in agriculture will hinge on collateral values and borrower profitability in an era of heightened risk. Producers tend to be bearing a higher share of the risk in the sector. These risks include increased financial, commodity and input cost volatility in conjunction with amplified contractual and counterparty risks. Effective risk management tools are essential to continued credit availability in

agriculture. I urge the committee to look at refining and expanding the risk management options available to producers. Moreover, increased emphasis on financial and risk management education is essential. Risk management tools are often complex and difficult to understand. Education will be a necessary complement to enhanced risk management tools. Successful producers will likely have to prepare more detailed financial statements and develop their risk mitigation strategies.

Continued and expanded funding of the successful direct and guarantee loan programs administered by the Farm Service Agency are very important to the development of beginning farmers/ranchers, socially disadvantaged farmers/ranchers, and selected family-sized operations. The credit programs have been an efficient method to leverage funding into credit for production agriculture. Agricultural lenders have learned to use these programs to manage their risks and expand credit availability.

Consideration should be given to increasing borrowing limits on direct operating and ownership loans. Farm real estate prices have increased, equipment is more expensive, and fuel, fertilizer, seed rent and other input costs are higher. For example, nonland cash costs exceed \$400 per acre in Illinois; cash rents on good to excellent farmland exceed \$200 per acre; and Illinois farmland prices on good to excellent farmland range from \$6,000 to 7,000 per acre. Credit limits of \$300,000 may be insufficient to meet the needs of moderate-sized family operations.

There are many intersecting issues surrounding the current financial regulatory reform. Restructuring or consolidating of financial institution regulators are being considered. The Farm Credit Administration (FCA) has been a firm, independent regulator for the Farm Credit System and Farmer Mac. This was especially evident during the recent financial crisis. The Farm Credit Administration, formed in the early 1900s, has an understanding of the risks inherent in agriculture and the food system. It is in the best interest of the two successful agricultural GSEs for FCA to remain as their primary and independent regulator.

In summary, most agricultural lending institutions have navigated the economic turmoil through prudent lending/investing, effective loan underwriting, strong capital management, and successful risk management. New and increasing risks in agriculture will likely result in more winners and more losers. Risk management by lenders and borrowers should be a high priority. Policy makers can assist through developing and enhancing existing tools and investing in producer education.

This first segment on agricultural credit relates to my research and education responsibilities. Next, I would like to discuss the administrative component of my academic responsibilities. Richard Vogen, Director of Planning, College of Agricultural, Consumer and Environmental Sciences assisted in developing and organizing this portion of the testimony.

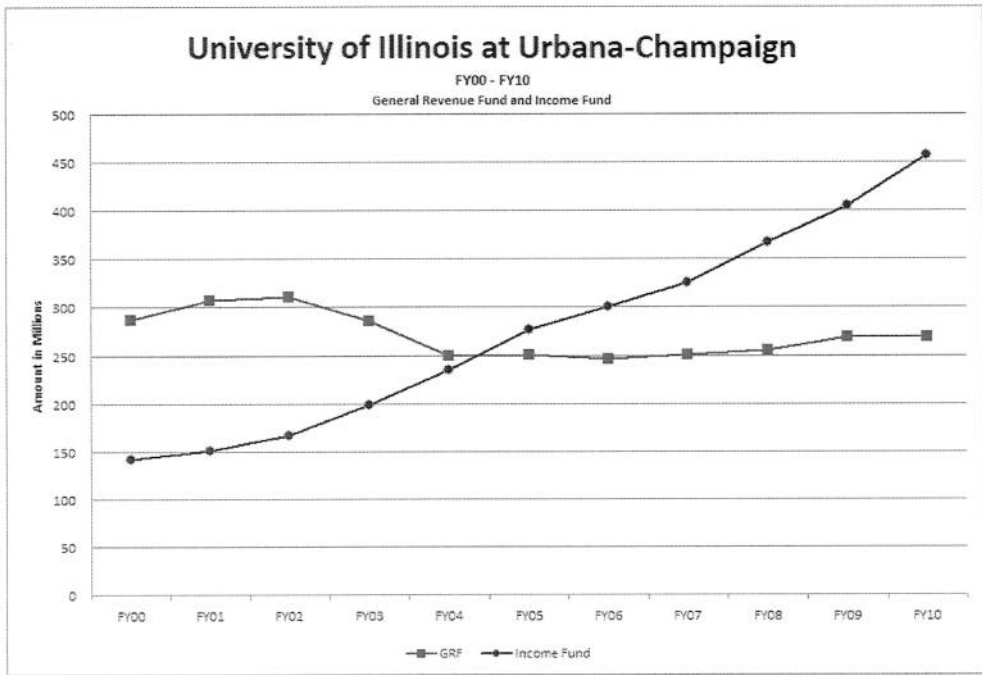
### **Changing Landscape for Research, Education, and Extension**

As the farm bill discussion evolves, establishing the next federal framework for food, agricultural, natural resource, and rural development policy, I would be remiss in not calling attention to another watershed of change taking place right now – with respect to the research, education, and extension infrastructure that has served us so well for many decades. For over a century, this nation prudently invested, by partnership with the individual states, in an integrated approach to discovery, learning, and application of knowledge. By establishing successful land-grant colleges and universities, agricultural experiment stations, and extension services, the public across America contributed to a powerful engine of growth and learning; resulting in the most successful food and agricultural system the world has ever seen, reduced rural poverty, and improved understanding of our resources and environment.

Today, many of the most urgent issues facing policy makers fall squarely within the purview of this land-grant system, such as global food security, climate change, use and protection of land, water, and other resources, health and nutrition, and energy independence. Some of the most exciting developments in science and technology are at the nexus of life sciences and other disciplines, played out in the domains of food, agriculture, and natural resources. Even in this most recent period of economic turbulence, these sectors of our economy proved to be resilient, a bellwether of opportunity in the future.

However for at least two decades, the federal investment in the land-grant infrastructure stagnated, in evidence by the flat nominal and declining real investments in Hatch and Smith-Lever appropriations. The recent increase in competitive research funding through the Agriculture and Food Research Initiative (AFRI) is one hopeful sign that the needs are being recognized. Ironically though, the states, especially those with large populations and entitlement obligations, are divesting in their higher education, research, and extension infrastructure related to agriculture. The longstanding land-grant services that rely on Federal-State partnerships are in an accelerated period of disinvestment.

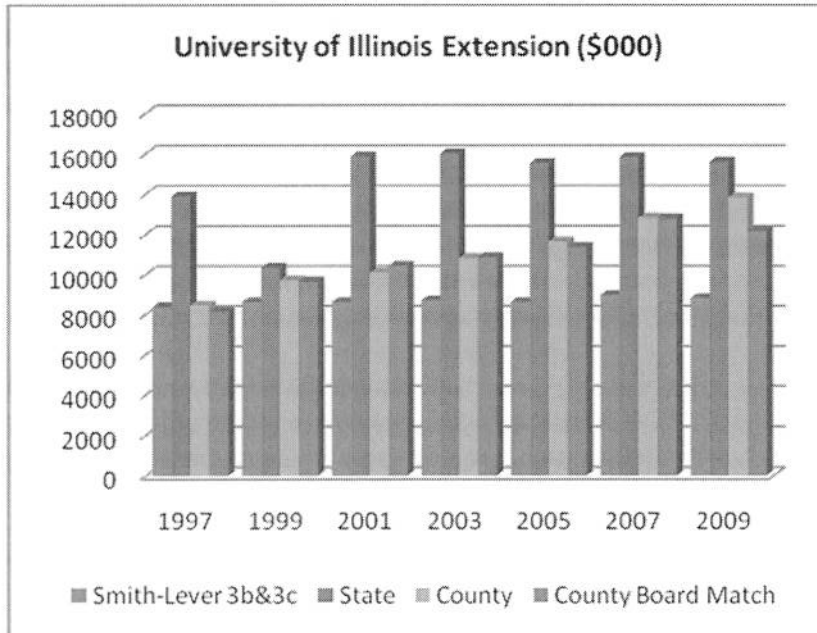
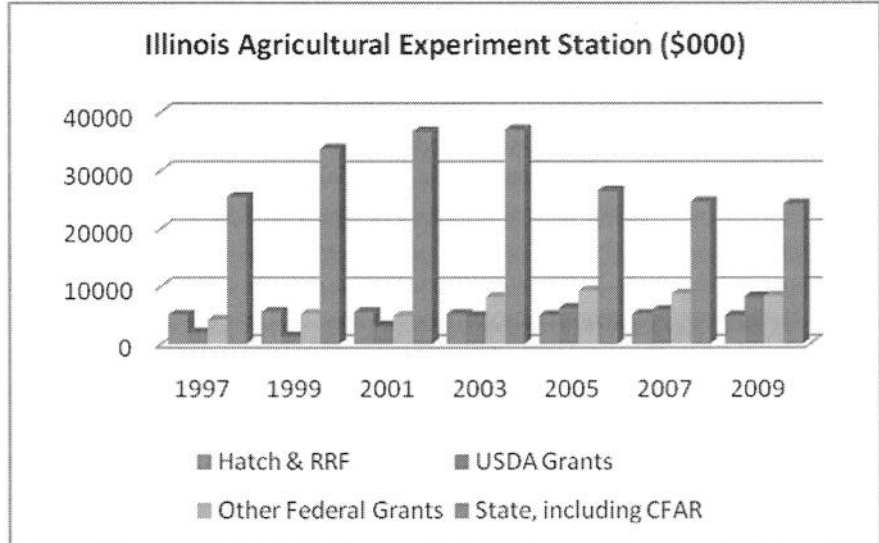
Let me illustrate with the situation I know the best. In the case of the University of Illinois, the State is seriously in arrears for its currently obligated funding to higher education, and the State's budget deficit has widened dramatically. At stake are the central principles of the land-grant university and whether this mission is consistent with both the escalating share of costs borne by undergraduate students and the direction of a research intensive university. In the case of the University of Illinois, as in many of our sister institutions, the contribution of State resources (GRF) to the University has been outstripped by contributions of student tuition (Income Fund). A fair question is whether students should be asked to pay for public services in the research and extension missions. To an increasing degree, the answer is no. The consequence of that trend is that fewer resources are available to maintain the land-grant



infrastructure, train the next generation of leaders and scientists, or address the local issues of agriculture, food, and the environment. A measure of this disinvestment is the 25% decrease in faculty capacity in our College of Agriculture, Consumer and Environmental Sciences over the past two decades.

The emphasis on competitive funding at the national level exacerbates these trends. Locally relevant problems are neglected in pursuit of science in the context of larger, complex issues; or by seeking support from granting agencies with higher potential returns, but less relevance to food, agriculture, and natural resource issues. The inevitable result will be a narrowing of the field to fewer successful researchers and institutions. It is reasonable to ask if that concentration of science in the most competitive research institutions will be able to serve many local, state or regional concerns.

This can be illustrated by the trend in public funding streams for the Illinois Agricultural Experiment Station, where federal formula funding (Hatch) has remained flat, while State funding peaked several years ago and has fallen substantially.



A similar story is may be told for University of Illinois Extension. The primary source of federal formula funding (Smith-Lever 3b & 3c) has changed little in nominal dollars over the past decade, while the State's investment has waxed and waned. The real growth for Extension is evident in the funding support by counties for local programs.

These trends serve to demonstrate the main point; as states struggle with mounting fiscal problems, the historic Federal-State partnerships that

serve the food, agricultural, and natural resource sectors of our nation are in peril. The irony of this circumstance is that there is a resurgence of interest in the principles of the land-grant philosophy, which for us means actively discovering, advancing, and integrating new knowledge to ensure nutritious and safe food, sustainable and innovative agriculture, renewable sources of energy, strong families and communities, and environmentally sound natural resource management to benefit the people of Illinois and the world.

I urge the committee to carefully consider this issue, as deliberations proceed for a new food, agricultural, and natural resource policy framework in the United States. Thank you for your time this morning.

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## Curriculum Vita, April 2010

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### EDUCATIONAL BACKGROUND

University of Illinois at Urbana-Champaign, B.S. Agricultural Mechanization	1980
University of Illinois at Urbana-Champaign, M.S. Agricultural Economics	1982
University of Illinois at Urbana-Champaign, Ph.D. Finance.	1992

### ACADEMIC POSITIONS

Assistant Professor, Department of Agricultural Economics, Texas A&M University	1992-1997
Assistant Professor, Department of Agricultural and Consumer Economics, Department of Finance, UIUC	August 1995 to July 1998
Associate Professor, Department of Agricultural and Consumer Economics, Department of Finance, UIUC	August 1998 to July 2007
Professor, Department of Agricultural and Consumer Economics, UIUC	August 2007 to present
Head, Department of Agricultural and Consumer Economics, UIUC	August 2009 to present

### TEACHING EXPERIENCE

Case Studies in Accountancy and Finance(ACE 447)	2001 to present
Contemporary Issues in Accounting and Finance(ACE 341)	2001 to 2008
Computer Applications and Data Analysis in AgAccy (ACE 499)	2008 to 2009
Financial Intermediaries (FIN 301)	1995 to 2002
Financial Markets and Agribusiness Study Course (ACE 199sc)	1997 to 2008

### HONORS, RECOGNITIONS, AND OUTSTANDING ACHIEVEMENTS

Outstanding Graduate Faculty Award presented by the Graduate Student Organization of the Department of Agricultural and Consumer Economics, 1995-1996.

Hughes Undergraduate Teaching Enhancement Award, 2002.

Distinguished Group Extension Award, *farmdoc*, The American Agricultural Economics Association, 2002.

College of Agricultural, Consumer and Environmental Science Team Award, University of Illinois at Urbana-Champaign 2004.

Donald A. Holt Achievement Award, Illinois Council on Food and Agricultural Research 2004.

Cool Site Award – Content, University of Illinois Webmaster's Forum 2004.

Board of Directors, Farm Financial Standard Council, 2005-present.

Fellow in the Academy of Entrepreneurial Leadership, 2006-present.

College of Agricultural, Consumer and Environmental Science John Clyde and Henrietta Downey Spittler Teaching Award, 2006.

Advisory Committee for Myers Chair of Finance, Cornell University 2005-present.

Outstanding Agricultural Economics Web Decision Tools Award, The American Agricultural Economics Association, 2008.

Included on the "Incomplete List of Instructors Ranked as Excellent by Their Students", 1996, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008.

NACTA Teacher Fellow Award, 2009.

College of Agricultural, Consumer and Environmental Science Team Award, University of Illinois at Urbana-Champaign 2010.

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program, July 1998.

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## SELECTED PRESENTATIONS

CBAI Agricultural Lending School 2000-2004

- Agricultural Credit Analysis, Agricultural Loan Pricing, Credit Scoring of Agricultural Loans
- Advanced Agricultural Credit Analysis, Lending to Marginal Operations, Lending to Young and Beginning Farmers

Farm Financial Standards Council, Bloomington, IL, August 2000. Benchmarking and Peer Group Analysis

National Agribusiness Conference, Illinois CPA Society, Bloomington, IL, August 14, 2000. Financial Analysis and Management Information

## Systems for Farmers

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Farm Credit Bank of Texas, Association Boards of Directors -- various locations, January 2002 Credit Risk Management in Uncertain Times

National Ag Credit Committee, Chicago, IL 2002 Merger and Acquisition of Agricultural Banks

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California Agricultural Lending Institute, Fresno, CA, June 2003. Credit Risk and Management

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CBAI Annual Meeting, September 2004 Agricultural Lender Outlook

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Illinois Commodity Conference, Normal, IL November 2005 Illinois Farm Income Levels and Role of Government Payments

Kansas State University, November 2005 Illinois Farm Income and Projection Model

Women in Agriculture, March 2006 FAST Tools for Financial Projections

China Executive Leadership Programs for Financial Institutions (Bank of China, Bank of Communications, Shanghai Development Bank, China Development Bank, Agricultural Bank of China, Agricultural Development Bank, Import Export Bank of China, Chinese Association for International Exchange of Personnel, Bank of Shanghai, Qingdao International Bank ), Urbana, Shanghai, Beijing, Qingdao, 2001-2010, Presentations include:

- Bank E-Finance: Banking Models in Financial Services
- Bond and Credit Derivative Products
- Concepts of Loan Pricing
- Consumer and Residential Credit Risk
- Credit Risk Management in US Banks
- Debt instrument innovation
- Derivative Securities
- e-Finance, e-Commerce and the Future of Banking and Securities
- Financial Modeling and Forecasting Under Uncertainty
- Fixed Income and Debt Securities
- Interest and Market Risk Measurement, GAP Analysis, VAR, Duration and Simulation Analysis
- Interest Rate Risk in Financial Institutions: Measurement and Management
- Loan Accounting and Credit Risk Measurement
- Loan Syndication Products and Practices
- Securities Markets and Regulations
- Securitization Concepts and Practices
- Spread Management, using Derivatives Contracts
- Strategies for Managing Interest and Market Risk
- Structured Finance Products and Practices
- Underwriting Securities

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Pacific Economic Cooperation Council, February 2009, [Financial Crisis and Access to Credit for Agriculture](#)

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