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An Agricultural Law Research Article

**Essay: Agricultural Attorneys Face Exciting Farm
Credit Opportunities and New Global Realities**

by

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ESSAY: AGRICULTURAL ATTORNEYS FACE EXCITING FARM CREDIT OPPORTUNITIES AND NEW GLOBAL REALITIES

Eric P. Thor*

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I. OVERVIEW AND SUMMARY

Attorneys, farmers, ranchers, and agribusiness leaders today face exciting challenges that will affect their businesses and practices in many ways. This essay outlines some of the changes that will influence farm credit and the agricultural banking industry.

Today's farmers, ranchers, and agribusiness lenders and leaders must be more competitive with global industry. Whether one is selling or financing cotton, corn, beef, or kiwis, the next century will be challenging for American farm credit, agriculture, and agribusiness. As a result, service providers, such as bankers and attorneys, will face similar challenges as they serve farm credit and agribusiness. Attorneys must be more client focused than ever before. The client base and the needs of the sector are changing to meet the new realities of the global marketplace and competitive factors in their business.

Production, processing, and marketing to add value and reduce costs is becoming more integrated with financial results for agribusiness and agricultural clients. For example, the American poultry industry has shown in the past decade that American agriculture can increase production dramatically, cut prices by half, and increase profits. This is important for bankers and service providers. Bankers will want to lend and be repaid from traditional sources, including cash flow, and the sale of products and commodities.

Agribusiness and agriculture are moving toward world market practices and prices as sales and profitability are tied to exports. World markets are influencing all major segments of agriculture and agribusiness. Commodity futures markets

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integrate the supply and demand of many major commodities. Today, bankers depend on this for commodity and currency risk management for their clients and their own institutions. For example, the Farm Credit Funding Corporation uses international markets to raise capital for American farmers, ranchers, processors, and integrators.

Agricultural clients and attorneys must forge new ways to minimize risk as government support for agriculture is reduced domestically and internationally. Large commodity support programs and price supports will be phased out during the next seven years. Commodities in regions of the United States that are not competitive on the world market will have to adapt to the new market and customer needs. For example, Arizona is now a large producer of wheat for pasta and has nearly thirty pasta-producing companies in the state.

Globally, new and updated trade agreements are redefining major issues for agriculture and agribusiness. This affects bankers and attorneys. For example, the first two years of The North American Free Trade Agreement (NAFTA) have impacted the policies and business climate of Mexico and its hemispheric partners in many ways. First, private and public sector projects are integrating and strengthening the agribusiness and natural resource infrastructure. Second, agribusiness is refocusing and enhancing trade. The changes include "balance of payment" concerns for international and domestic farmers, agribusiness, and ranchers. In the United States, agribusiness adds to the balance of payments. Also, agribusinesses are improving the marketing of value-added products. This effort requires the creation of entrepreneurship throughout the Americas. Fourth, privatization and re-engineering are key trends in most countries. Companies, cooperatives, and even government owned enterprises are finding agribusiness revitalization important for domestic and international business reasons. This creates market integration and allows the United States to be more competitive globally.

Each of these trends will affect legal needs and challenges in attorney-client relationships. Farm credit bankers and attorneys must adapt to new financial conditions or their clients will lose competitive positions. One major reason for these adaptations is to take advantage of the global trends. For example, the European Union, Asian Pacific Economic Community (APEC)--including Japan and China--and the Asian "Tigers" have shown increasing agribusiness success. All these regions need American products. Focusing on international trade, balance of payments, and financial opportunities for the private sector and cooperatives can have a dramatic effect on a country. Bankers, attorneys, and their clients must adapt to market integration and new market conditions.

II. AGRIBUSINESS CHANGES AND MEGATRENDS

This Essay focuses on agribusiness changes and megatrends that will affect agricultural attorneys, bankers, their clients, and farm credit in America. This is particularly important because less than 2% of the population is in traditional agriculture today. Recent events show new realities in farm credit including the fact that few farmers, ranchers, and production personnel are needed in the market. Furthermore, the future suggests this trend may continue as technology allows more production, processing, and "value-added" with less people. Fewer than five million people are in traditional agriculture today.

While the number of farmers is declining, the value of the U.S. food and fiber industry continues to grow to more than \$380 billion. At the center of the global change is the business of food and fiber. These enterprises produce, package, and distribute goods used by consumers daily. There are more than 285 million consumers in the North American market, 860 million in its hemispheric partners, and about 6 billion globally. By the year 2020, if the forecasts of the Cairo Conference are correct, several billion additional consumers will be customers of the agribusiness system. Additionally, in many countries, more than 40% of the population is directly employed in production, processing, transportation, or marketing of food and/or fiber products.

Creating a new agribusiness integrated market climate and improving trade and economic performance are new challenges in efforts to move toward a more productive and efficient agribusiness and food system. This means that bankers and the other service providers must work with the major companies and "value-added" providers as well. These include farmers, processors, transporters, institutional food clients, retailers, and others. These major integrators are influencing agricultural systems. Furthermore, economic and financial developments are changing the trends. The following section of this Essay reviews a few of these in light of current economic and financial developments.

First, North American producing and trading areas are collectively experiencing stronger population and income growth than many other regions. Even prior to NAFTA, agricultural trade had been growing steadily among the United States, Canada, and Mexico. U.S. exports to North America have been growing faster than any other region, including Europe and Asia. Agricultural exports grew to \$2.8 billion in 1994. In 1996, U.S. exports to NAFTA partners are expected to fluctuate, possibly downward. However, if Mexican currency stabilizes as is indicated, NAFTA trade will resume its upward climb. Forecasts for 1996 suggest "brisk economic growth for several years . . . beyond 1996." Trends suggest that in the next century North American agribusinesses will continue to expand to meet growing population and employment needs. The increased interrelationships of these economies will become more self-evident.

With the passage of the NAFTA and the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), North American markets have experienced stronger trade and income growth through market integration. International Economics estimates that the full implementation of NAFTA and GATT could add imports of more than \$170 billion to Latin America and \$130 billion for exports. Mexico and the United States take advantage of this through agreements with Costa Rica, Venezuela, and other southern neighbors.

For rural lenders, government officials, and agribusinesses, these agreements will change the way consumers, bankers, farmers, cooperatives, and ranchers deal with each other and the world markets. With the first four years of NAFTA almost history, it is interesting to note that trade between the three partners has been positive. Total trade is almost \$3 billion between Mexico and the United States. *The Wall Street Journal*, in a special supplement titled NAFTA, argued that the first four years has affirmed the positive aspects of trade growth.

We must remember that by the year 2000 more than half of the Americas' population will live in the Southern Hemisphere. Market integration is the key for NAFTA with trade and investment in Central and South America. We will have a population of 843 million by the turn of the century. This is just four years away. By the middle of the next century 1 billion people will be in our hemisphere. It will be one of the world's largest marketplaces. For example, South American regional trade has doubled in the past five years. Agribusiness credit is also an increasingly important component of the country's competitiveness.

The trends raise a number of issues and questions for agribusiness leaders, traders, bankers, and other service providers. Without a fully functioning and competitive agribusiness strategy, it is difficult to compete and work in the emerging global agribusiness marketplace. Agribusiness throughout the hemisphere will be affected. The following section of this essay will outline these key trends.

In many parts of the country, social and political systems are tied to agriculture and government as a partner with agribusiness. In the United States, many models are available for consideration by our hemispheric partners. For example, the Farmers Home Administration (FmHA), a U.S. government-sponsored rural credit agency, is one of the largest agricultural and agribusiness financial institutions with close to \$70 billion in loans. The Commodity Credit Corporation (CCC) is another institution that provides loans to American agribusiness and agriculture to help the U.S. farmer compete. Rural utility associations, which provide electric, water, conservation, and environmental management in rural areas, are another example. All these institutions have programs that are somewhat flexible and change over time in response to rural, national, and world economic, financial, and political pressures. In the United States, distinctive public and private institutions provide credit, water and land management, and environmental conservation. These financial institutions are subject to oversight on a national level. Additionally, in the United States some state-chartered financial institutions serve local agricultural and rural institutions.

Legal issues are very important. For example, the U.S. government and state statutes under the Uniform Commercial Code (UCC) agricultural credit system oversee the competitive environment of major lenders. Additionally, U.S. government agencies such as Farmer's Home provide credit under special circumstances to individuals with weaker credit including young farmers and farmers who have experienced disasters. The two major regulators of agricultural debt are the Federal Deposit Insurance Corporation (FDIC) for commercial and community banks and the Farm Credit Administration (FCA) for farm credit institutions. These government-sponsored organizations are important avenues of credit. For the Farm Credit System, there is another organization called the Farm Credit Funding Corporation. This is mentioned because of its importance in

gathering funds to lend for agriculture. As a government-sponsored enterprise, the Farm Credit Funding Corporation is able to sell securities at government desks around the world and offer favorable rates. Last year it raised more than \$90 billion for U.S. agriculture. The average farm credit funding interest rate was 10 basis points over U.S. treasuries. In 1996, long-term rates have risen as inflation is expected in 1997.

III. THE NEW REALITIES

In the U.S. system, many institutions provide production credit, intermediate-term and long-term credit. Non-bank institutions such as equipment dealers and insurance companies also provide credit to the marketplace. Many U.S. financial institutions currently provide credit to the Canadian agribusiness system. Several companies compete in the American and Canadian markets. Total lending to agribusiness sectors serving the agricultural industry is more than \$200 billion in the United States. Total hemispheric lending is not available, but must exceed \$1 trillion. The United States needs to focus on special needs in this area and adapt to the changes. Major institutions serving this market include independent and major commercial banks, the U.S. Farm Credit System, and the insurance industry. Major products are farm real estate mortgages, medium-term loans, and production credit, usually issued annually. For bankers and attorneys, major characteristics of the new realities include the following:

- (1) being customer driven;
- (2) serving new agribusiness, agriculture management, and customer needs;
- (3) new technologies, megatrends, and communications affecting all levels;
- (4) financing in a new era with new "Freedom to Farm" legislation; and
- (5) new challenges including Federal Agricultural Improvement and Reform (FAIR).

Attorneys will have to address a number of legal areas of concern including: (1) farm and agribusiness collateral becoming more expensive and complex; (2) international disputes and the impact of trade agreements becoming more common as shown by the mad cow, karnal bunt, and corn blight issues; (3) growing loan documentation issues; and (4) environmental issues and rights. Other issues include a concern about rights and responsibilities of technology providers, including irrigation systems, storage systems, quality issues, seeds and performance of crops, livestock, water and irrigation disputes, and land titling issues. Additionally, environmental issues such as water and new regulations will continue to focus all of us on issues that need market-oriented solutions, including Title X Compliance for Mortgages, "lead based" risks in paints, field services for land, preliminary assessments of radon, and storage tank risk assessments.

As a result of the these trends, cash receipts continue to grow; but income remains flat with little growth. Cash income for farmers is tied increasingly to exports. Global agricultural market shifts caused by the transformation of

consumer and industrial consumption are changing the need for credit and the type of credit needed. In 1995, the United States exported more than 50% of some commodities and specialty products. Trade financing and trade credit are more important than five years ago.

The global market is now a reality for the food industry and agribusinesses. Current forecasts by the United States Department of Agriculture (U.S.D.A.) of U.S.-South American trade suggest that by the year 2010, total trade will double. For fruits and vegetables, cotton, citrus, and many of the more than two hundred agribusiness products exchanged in both directions, trade has increased over 50% in the past five years. Furthermore, as regions continue to grow, transportation and telecommunications will expand.

The Arizona Republic printed a lead story on the challenges we face. The article, titled "Breaking the Border Bottleneck-But How?" points out possible gains of integration for all the southern U.S. ports of entry. That will be expensive but necessary to increase trade, investment, and joint ventures.

Because of GATT and NAFTA, bank barriers are coming down in the next decade. Today, American and Western European financial institutions are helping lead the world in agribusiness lending technology.

At a Harvard agribusiness seminar, executives from more than twenty-two nations studied the changes in the Mexican agribusiness company, *Empresas La Moderna: Tobacco, Fruit, and Vegetables*. This company is among those firms taking advantage of its agribusiness base. *Empresas La Moderna* is poised to take advantage of the market and add value in its domestic and international markets. It is a "world class" company serving markets 12,000 miles away in Tokyo, New York, Miami, and Europe. Profitability for this company exceeds most others in North America. The Americas need to develop companies that have this breadth in agribusiness marketing and finance.

IV. IMPLEMENTATION MEANS CHANGES

Because American producers, processors, and retailers serve a global market encompassing 830 million Americans, agribusiness and financial institutions must adapt quickly to finance their clients. GATT, WTO, and NAFTA implementation will augment change in a number of areas including the following:

- (1) Locking in almost \$9 billion in total agricultural trade between the United States, Mexico, and South America, Costa Rica has signed agreements to participate with the United States. This allows both countries to expand their Canadian markets in areas including fruits, vegetables, and processed food products. Estimates suggest that by 2010, total agribusiness trade will increase 50% or \$12 billion. This will make the United States the premier agribusiness market in the world.
- (2) With 860 million people in South and North America, implementation also assures eventually one of the largest common markets in the world. We have fewer language and business barriers than Europe or Asia. We have three major languages, an expanding infrastructure, and a modern telecommunication

system. The Americas are growing faster than Europe and already have a higher standard of living and income levels.

(3) As countries focus on improving export opportunities for high valued, manufactured products, increased production, transportation, and manufacturing efficiencies will result. Poultry, as an example, has tripled in export shipments in the past five years.

(4) High-value products account for more than 80% of nearly \$500 billion in world agricultural trade. In the United States, we have not focused on developing the worth of these products. Processed products comprise about 60% of these items. Processed livestock products alone represent 24% of the value of world food and agricultural trade. This category is larger than the value of all bulk products, which represent 19% worldwide. Processed grains, oilseeds, and horticultural products also are increasing in importance.

(5) In agriculture, we must remember that high-value products have a higher multiplier than do bulk products. A dollars worth of high-value agribusiness exports generates about \$1.70 compared to \$1.50 in bulk products for our economy. More than 55% of America's agricultural export jobs are the outcome of high-value products. It is no wonder that Europeans and the Japanese focus on their own high-value exports. Categories such as mineral water, horticultural specialties, and some cheese types are dominated by imports because they have developed brand and customer loyalty. Americans are now focusing on this area, but our efforts need to be expanded. Modern refrigeration, transportation, and storage systems allow us to be competitive in these areas. We can ship, truck, or fly products anywhere in the world in a matter of days. With trading partners in Europe and Asia, it is time to expand our opportunities.

In each of these areas, agribusiness banks will find new opportunities for loan demand and financial services. Consequently, the integration of agricultural and agribusiness trade will help financial institutions generate new opportunities for earning.

V. THE ROLE OF TECHNOLOGY

Technology is an important area of change affecting agricultural attorneys. Bankers can now communicate thousands of miles away and serve clients in distant and remote states. More interaction occurs between the parties in negotiations. Major questions remain concerning the state and technology for farm credit and finance within the food industry and agribusiness institutions. The technology of agriculture and agribusiness financial institutions is evolving in North and South America. Changes in telecommunications, computer networks, accounting systems, and credit analysis systems make it possible for large and small, public and private agricultural and agribusiness banks to conduct business, provide trade finance, strengthen payment systems which accept bank deposits,

complete Automated Clearing House (ACH) functions as well as analyze credit, and communicate with customers. The payment and ACH systems in the United States and Canada are beginning to spread internationally to all major financial markets. Agricultural banks are beginning to strengthen ties with these organizations. Bigger is not always better.

Technology allows government institutions and central banks to regulate markets and sales institutions throughout the state, nation, and to a more limited extent, across borders. "World Class" banks in America use technology as a major advantage in the marketplace. Bureaucrats and government regulators are beginning to adopt new technologies. Agribusinesses can use technology to mitigate the regulators. Today's fast-paced global markets operate twenty-four hours a day. Commodity markets are linked to financial markets by satellite technology.

Another important area is irrigation systems and water management technology. In the United States, water and irrigation systems are divided into special districts that are managed locally by farmers under special agreements set up by the state and federal government. Arizona is familiar with the concept of issuing water district bonds to raise capital. In the last decade, U.S. financial institutions have issued more than \$100 billion in water and conservation bonds. The world can build upon this knowledge and seek funding alternatives that are effective in the international markets. New derivative products will expand this market greatly. In an issue of *Latin American Finance*, a number of ideas were highlighted that are being adopted in many countries in the region. Irrigation systems are expensive, but they can be important when adopting new methods and systems for agriculture. The ideas should be considered.

Agribusiness banks and financial institutions can review their customers' records on a continuous basis. This provides additional opportunities and challenges as the distance and scope of the credit markets and customers change. Evolving technologies allow financial institutions to expand throughout the country. Knowledge of Spanish and cultural ties enables them to expand and reach rural bank customers. This easily could be extended to all of South America. South America represents a market of more than 500 million people with an estimated 200 million persons in agriculture. Central and South American markets are the fastest growing economies and increasing per capita incomes in the world.

For agribusiness marketers, the Internet (a global electronic information system) and the Agribusiness Information Highway--similar technological systems --allow institutions to link with financial intermediaries, markets, and other agricultural regions in the growing world financial network. This network enables farmers, agribusinesses, financial lenders, insurance companies, and financial cooperatives to link together and conduct business.

Today, it takes less than an hour for deposits or funds to be transferred from the United States to a financial institution 10,000 miles away. Thus, financial institutions can serve any of the 300,000 commercial farmers and 3 million agribusinesses in the United States. It is one of the many thousands of enterprises that is committed to the emerging agribusiness industry. Similar customers can be linked in Tokyo, London, or Moscow.

Technology is an important consideration for U.S. farm credit institutions because agribusiness and agricultural investment, from the United States and other

key countries including its major trading partners--Japan, Mexico, Canada, and the European Union--are needed to implement proposed restructuring in the agribusiness sectors.

Thus, technology requires agribusiness banks to compete with an increasing number of nontraditional lenders, international banks, investment banks, and insurance companies. To compete in this market agribusiness clients expect leaders to focus on the changing role of "value added" products and market integration. Profitability continues to include further integration of "value added" products and commodities.

VI. MAJOR LEGAL ISSUES AND POLICY CHALLENGES

Agricultural bankers and attorneys are witnessing the movement of strong financial, economic, and political forces that will affect agricultural lenders profoundly. The traditional instability of agricultural lending will remain, but new risk management tools will help. Changes in the legal and financial arena that are making new markets and partnerships possible. Painful economic and financial restructuring will follow the euphoria of change. We should recognize these added challenges to international development as opportunities. Agriculture and agribusiness will play an important role in that area. Nevertheless, questions will remain.

Rural and farm development are concerns as agribusiness and agriculture diversify. Large farmers require different legal and banking services than do small farmers. The new financial order will help continue the financial restructuring trends of the past five years. Agribusiness, cooperative, corporate, and government treasurers are discovering new, innovative, cost effective sources of capital through globalization of the capital markets. Individual nations are redesigning long-standing financial guidelines and plans into a world standard. This is affecting agriculture directly as it did to the home mortgage industry, the automobile and equipment industry, and any market segment that requires large amounts of long-term capital.

This will be important to the more mature segments of the industry. Financial service institution executives and agribusiness leaders are able to sell various securities at lower spreads than in the past decade. In the United States, the oversight of financial institutions by regulators has changed as a result of the financial bailouts and structural changes of the 1980s. In the first half of the 1990s, earnings have recovered in the United States and are setting new records.

New laws have impacted the structure and profitability of financial institutions. In the past five years, several major laws have been passed giving United States regulators new and expanded powers at a time when the global banking market is becoming more competitive in all major market segments including agribusiness and agriculture. Financial institutions are also evolving as privatization of banks has helped more than 100 banks return to the private sector.

Laws such as the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), Financial Institution Uniform Credit Act (FUCA), the 1992 Futures Trading Act, and the Community Reinvestment Act greatly expand regulatory powers. Former Treasury Secretary Lloyd Bentsen, in a recent article in the *Independent Banker* highlighted the direction of regulations by saying,

“Our regulatory approach must be balanced to insure both bank profitability and safety and soundness.” The new laws greatly expand regulatory institutions powers and oversight. Regulators electronically audit accounts and customers without leaving Washington, or Lima, or wherever their offices are located.

VII. CONCLUSION

Attorneys, bankers, and lenders to agribusiness and agriculture will have to help convert structural and policy challenges into positive fluctuations in cash flow and asset adjustments for their institutions and their clients. Importantly, these transformations will set the competitive position of America’s agricultural associations and banks for the next century and millennium.

In 1997 and the next century, America’s agribusiness and agricultural lenders, attorneys, and borrowers face a new era in agribusiness opportunities. GATT and NAFTA provide an opportunity to help remake the hemisphere with sustainable agribusiness economic growth. This growth must be compatible with major environmental issues, job creation, and increased wealth for all Americans. For some businesses and institutions, this era will demonstrate that a positive environment can be created for agribusinesses, attorneys, farmers, and ranchers alike.