THE FARM CREDIT COUNCIL

July 26, 2013

The Honorable Max Baucus
Chairman, Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Orrin Hatch
Ranking Member, Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Hatch:

The American Bankers Association (ABA) and the Independent Community Bankers of America (ICBA) recently wrote to you suggesting that taxes on American farmers and ranchers should be increased by altering the tax status of the institutions of the Farm Credit System (FCS). As a farmer and rancher from Chester, Montana, and on behalf of the half-million farmers and agricultural cooperatives that own the institutions of the Farm Credit System, we strongly disagree and urge you to reject the ABA/ICBA proposal.

It is most commendable that you have sought input on reforming the tax code. Specifically, you said that tax breaks should be judged on whether they help the economy, make the tax code fairer, or effectively promote other important policy objectives. The current tax treatment of Farm Credit System institutions fulfills all three of these goals and has done so for 97 years. It should not be changed.

Congress established the Farm Credit System to be a permanent source of competitive financing, owned and controlled by the farmers, ranchers and cooperatives that borrow from Farm Credit institutions. Congress carefully designed the Farm Credit System to meet a specific mission in supporting agriculture and rural America. Farm Credit was organized with a cooperative structure, access to the financial markets as its source of funds, no deposit taking authority, a limited scope of eligibility for its loans and a tax status designed to help it accomplish its public mission. This is a carefully balanced package designed to ensure that agriculture and the infrastructure it relies on will always have the capital they need to ensure that our citizens have a reliable source of food and fiber. The Farm Credit System has proven to be a well-designed and effective tool and this is proven out not only by the contribution agriculture continues to make to the economy but also by the manner in which the institutions of the Farm Credit System have conducted themselves. Farm Credit institutions did not engage in the sub-prime fiasco that recently cost the economy so dearly.

The institutions of the Farm Credit System are very different from commercial banks. Farm Credit institutions get their direction from the farmers, ranchers and the cooperatives that borrow from and cooperatively own them. Our stock ownership, the investment we individually make in the System, does not appreciate in value. It is not publicly traded. Our stock is not used to enrich management or our owners. Instead it serves to provide us the comfort of knowing that our institution will continue to be there, in good times and bad, reliable and competitive, and focused on meeting the needs of agriculture and rural America for generations to come.

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As is typical of ABA and ICBA, their letters are misleading and factually lacking. The ABA and ICBA complain that Farm Credit has substantial advantages over them and that their members are suffering as a result. The facts do not support their claims. Agricultural banks have always been a highly profitable sector of the banking industry. A study by the Federal Deposit Insurance Corporation of community banks in 2012 concluded that over their study period they found that those specializing in agriculture "were the strongest performers over the entire study period." ABA's own annual bank performance reports consistently demonstrate the unfailing strong performance of agricultural banks even stating "agricultural banks continue to fare better than the banking industry as a whole."[1] A study conducted by one Federal Reserve Bank found that, "Financial reports from ag banks indicate that their funding costs, or total interest paid to fund their earning assets, were lower than the funding costs of the FCS as a whole." (emphasis added)[2]

The ABA and ICBA have each provided their own creative analysis suggesting that the Farm Credit System enjoys varying levels of tax subsidy. The ABA suggests you should compare the System's effective tax rate to the 29 percent effective tax rate that they claim commercial banks pay according to the FDIC. This is a misleading comparison at best. Because Farm Credit institutions are cooperatives, it would be more accurate to compare the Farm Credit System's effective tax rate with that paid by banks that are organized and pay taxes as Subchapter S pass-through entities. More than half of all agricultural banks are Subchapter S banks, and 92 percent of all Subchapter S banks make at least some agricultural loans, according to FDIC figures. An analysis of actual call report data shows that Sub S commercial banks pay an effective tax rate of 1.4 percent. This tax rate is considerably less than that paid by the Farm Credit System. Using ABA's numbers and subsidy theory, Subchapter S banks are subsidized to the tune of $2.4 billion per year or about $12 billion over the next five years assuming their profits don't go up over that period. The ICBA similarly just makes up a number that has no basis in fact regarding the additional revenue that would be generated by changing the tax treatment of Farm Credit institutions.

Furthermore, on the topic of taxpayer subsidies, both ABA and ICBA conveniently fail to mention the extensive taxpayer backing that banks enjoy. While they like to hold themselves out as the bastions of free enterprise and separate from government support, the facts belie this. The irony is that banks enjoy far more direct support from the Federal government than do the institutions of the Farm Credit System. They have direct access to the Federal Reserve. They enjoy direct taxpayer backing for their deposit-gathering operations. They enjoy the benefit of direct access to funding from not one but five government sponsored enterprises – the Federal Home Loan Bank System, Freddie Mac, Fannie Mae, and Farmer Mac – and they can even gain access to funding from the Farm Credit System. The GSE that community and other banks cooperatively own, the Federal Home Loan Bank System, is tax exempt and passes their earnings on to banks through dividends. The ABA and ICBA conveniently overlook these details because they don't fit with their "woe is me" story line. Yet, study after study by government (CBO to the Federal Reserve) and non-government entities have identified the substantial level of government subsidy extended to the banking industry.

We do appreciate the fact that ABA recognized the extensive amount of credit provided by Farm Credit System institutions to support young, beginning and small farmers, and the importance of maintaining a benefit to allow that to be continued. Being able to report the data from Farm Credit institutions

[1] American Bankers Association, 2008 Farm Bank Performance Report.
[2] Federal Reserve Bank of Kansas City, Financial Industry Perspectives, August 2009, "Lending Competition of Community Banks and the Farm Credit System." http://www.kansascityfed.org/publicat/fip/LendingCompetition08-09.pdf

regarding this requires each direct lending Farm Credit institution to track their borrowers far more intimately than commercial banks, since bankers need not gather and report data on the age, operation size or years of experience of their farm borrowers. In 2012 Farm Credit institutions made over 141,000 loans to small farmers (those with $250,000 or less in sales) representing $13.2 billion in new credit, almost 56,000 loans were made to young farmers (those younger than 35) totaling $8.8 billion and more than 68,000 loans were made to beginning farmers (those with less than 10 years of experience) totaling $11.5 billion.[3] Serving these specific categories of borrowers is just one part of the mission Federal law establishes for Farm Credit institutions.

The actual requirement of the Farm Credit Act is that Farm Credit institutions serve all types of farmers and ranchers that have a basis for credit, not just those who are small, young or beginning. The mission of Farm Credit institutions requires that we make credit available at competitive rates in all parts of the country. Together, the Farm Credit System made a total of $75.6 billion in new loans in 2012 and this includes loans to agricultural cooperatives and other farm-related businesses, rural utilities, rural water and sewer systems and rural homeowners not just to farmers and ranchers.

The uncertainty that surrounds current agricultural policy, the substantial and increasing variability in weather patterns and the expectation that commodity prices are likely to become even more volatile are all combining to create greater risk for agricultural producers of all sizes. Now would be the wrong time to create uncertainty for agriculture's most reliable, competitive and lead source of capital, the Farm Credit System. We believe strongly that tax reform should not harm Farm Credit institutions that are fulfilling their focused Congressional mission effectively and efficiently. Their letters demonstrate that neither the ABA nor the ICBA is concerned about what is best for agriculture. Their proposal does not meet any of the three criteria you have set out for tax reform. It would not help the economy, make the tax code fairer or be good for public policy. We strongly urge you to reject the self-serving, wrong-headed request of the ABA/ICBA.

We appreciate very much your consideration of our views.

Sincerely,

Mary E Fritz

Mary E. Fritz
Board Chair

cc: U.S. Senate

[3] Federal Farm Credit Banks Funding Corporation, 2012 Annual Information Statement of the Farm Credit System, March 1, 2013. http://www.farmcreditfunding.com/farmcredit/serve/public/pressre/finin/report.pdf?assetId=222216