PART III

Credit Market and Institutions

- Credit Supplies — Present and Future
- Relationship to Commercial and Low-Income
- Evaluation
- Suggested Improvements

Chapter 11

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Farm Credit Institutions

FOLLOWING THE FINANCIAL CRISIS on farms in the early thirties, far-reaching changes were made in our agricultural credit institutions and methods. What has been the result of these changes and how well has our farm credit system functioned since?

First on the list for critical evaluation are the credit institutions themselves, both operating and real estate loan agencies. What has been happening to these institutions and in what direction are they moving? Second, how well have these agencies been meeting the financial ups and downs of the farmers, especially the difficult times that farmers have been having during the squeeze of rising costs and falling or stationary returns? Finally, what progress, if any, has been made in more efficient handling of farm credit and in lower loan costs? Tootell addresses himself to similar questions in Chapter 17.

CREDIT INSTITUTIONS

Farm credit has increased substantially since the thirties, and the agencies extending the credit have improved their types of loan service to farmers. However, further improvement in loan services is needed. This subject is also discussed in Chapters 13, 15-18. In discussing these developments, operating credit agencies will be considered first, followed by real estate or farm mortgage agencies.

Institutions for Operating Credit

Commercial banks are the most important source of operating credit for farmers. While the Production Credit Associations and the Farmers Home Administration are of lesser importance, there is a host of merchants (including equipment, fertilizer, feed, and fuel dealers), as well as private individuals, who also provide farmers with operating credit. But these merchants and private individuals are not organized as credit institutions, and consequently are not discussed in this chapter. (Some aspects of credit extension by farm supply agencies are discussed in Chapters 8 and 26.) Nevertheless, they should not be overlooked in any over-all treatment of the farm credit problem.

Table 11.1. Operating Credit to Farmers by the Major Credit Institutions Outstanding on January 1, in Selected Years

Credit Institutions	1939	1946	1953	1960
		(million dollars)		
Commercial Banks	789	1,034	3,195	4,819
Production Credit Associations	147	195	599	1,361
Farmers Home Administration	351	413	348	397
Total	1,287	1,642	4,142	6,577
		(percent of total)		
Commercial Banks	61	63	77	73
Production Credit Associations	12	12	14	21
Farmers Home Administration	27	25	9	6
Total	100	100	100	100

Source: Based on data supplied by the Agricultural Research Service, USDA.

A comparison of the operating farm credit outstanding by agencies is presented in Table 11.1. Commercial banks have provided a major share of the additional operating credit to farmers. Since the end of World War II, commercial banks have increased their production credit advances (based on amounts outstanding January 1 of each year) by 3.8 billion dollars. Commercial banks on January 1, 1960, had over six times the total advanced as of January 1, 1939. It is interesting to note that the commercial banks not only increased their farm production loans in the 1946-53 period, but also in the 1953-60 period. In the single year ending January 1, 1960, loans extended by these banks increased by 658 million dollars.

Production Credit Associations, created by Congress in 1933, had 147 million dollars in outstanding loans on January 1, 1939. By the end of World War II their loan total had increased to 195 million dollars. In the next fifteen years, PCA loans increased rapidly. On January 1, 1960, total outstanding PCA loans amounted to 1.36 billion dollars. This amount was greater than the commercial banks had outstanding on January 1, 1946. On January 1, 1960, the Production Credit Associations had about one-fifth of the total operating credit advanced by the three main types of farm credit agencies. It is significant that the PCA's had their largest percentage increase during the 1953-1960 period. This is the period in which the "cost-returns squeeze" hurt the farmer most. The banks extended additional credit, and so did the PCA's. If the banks should find it difficult to continue expanding, the PCA's are available. This is a natural situation since banks have a primary obligation to their depositors and may find it necessary at times to curtail their loans in order to provide adequate reserves behind their deposits.

The Production Credit Associations do not have deposits; they obtain their funds for lending from the Federal Intermediate Credit Banks, who in turn get the funds from the central money markets on short-term debenture bonds or notes. This gives the PCA's a continuous open line of credit to extend to farmers as long as the Federal Intermediate Credit Banks can borrow from the central money markets.

Thus, in the commercial bank-PCA combination, the farmer is assured of credit as long as funds are available in the money markets, and there are few times that funds cannot be obtained in the money markets on securities with a reputation as good as that enjoyed by the Intermediate Credit Bank debentures. But in order to make this combination operate smoothly, the PCA's have to assume an obligation to fill in the gap wherever and whenever commercial banks find their funds loaned to capacity. Since PCA's cover the entire nation, it is obvious that the combination of available credit at all times can work if the PCA's are willing to take up the slack left by the commercial banks.

An interesting phase of the Production Credit Associations' activities is the relatively large business in the South. There are two states, South Carolina and Florida, where Production Credit Associations had more operating loans outstanding on January 1, 1959, than the commercial banks. The four states having the largest and the four having the smallest percentage of PCA loans in comparison with the commercial banks are presented in Table 11.2. All of the "high percentage PCA states" are in the South and east of the Mississippi River. All of the "low PCA states" are in the West. Part of the explanation for this situation is that the small loans in the South are not actively sought by the banks. For example, the average PCA loan in South Carolina in 1958 was $3,150, while the average size in Iowa was $16,500. But this is not the only reason, as indicated by the average PCA loan of $10,900 in Florida. Actually the PCA has an advantage because it can take larger loans than many commercial banks.

Table 11.2. PCA Operating Loans Compared in Percentage Terms With Total Operating Loans of PCA's and Commercial Banks, January 1, 1959

Largest percent		Smallest percent	
South Carolina	56	Iowa	7
Florida	52	Arizona	7
North Carolina	46	Nebraska	10
Mississippi	44	California	12
U. S. Average	20	U. S. Average	20

Source: Farm Credit Administration, Washington, D. C.

Another aspect of the nature of PCA loans is provided by examining the percentage of farmers served by the PCA's (Table 11.3). Iowa is the only state which appears low in both the PCA-bank comparison and the percentage of farmers served. Contrary to what might be expected, West Virginia and Alabama—both southern states—rank low on the list, while the high percentage states include eastern and western states not present in the states having a high percentage of PCA credit as

Table 11.3. Estimated Percentage of Farmers Using PCA Credit, January 1, 1959

Four high states		Four low states	
(percent)		(percent)	
Vermont	15	West Virginia	2
Montana	12	Alabama	3
Idaho	12	Iowa	3
Delaware	11	Wyoming	3
U. S. Average	6	U. S. Average	6

Source: Farm Credit Administration, Washington, D. C.

compared to commercial banks. Information on credit supplied by merchants and dealers is needed to explain this situation. This type of credit is especially important in the South. Although the PCA's provide more credit than do banks in South Carolina and Florida, they actually reach only an estimated 7 percent of the farmers in South Carolina and 6 percent in Florida. Consequently, both the banks and the PCA's have much room for expansion.

Farmers Home Administration loans have remained relatively constant since 1939, actually declining slightly since the peak in 1946 (Table 11.1). These loans are of several different types. For example, emergency crop and feed loans made up a sizable part of the total in 1939 and 1946, but in the years since have almost disappeared. In 1939 there were 171 million dollars in these emergency crop and feed loans outstanding, while the total at the beginning of 1959 was less than 6 million dollars. On the other hand, operating loans made by the FHA were up from 169 million in 1939 to 340 million in 1959.

The increase in operating loans by the FHA is a major success in that it has demonstrated that supervised credit will work if restricted to operators who possess managerial ability. Part of the success, of course, is due to the quality of the supervision. When it is recognized that the borrowers of the FHA operating loan have to be turned down by a commercial bank or a Production Credit Association before they are eligible, it makes the good repayment record on these loans stand out as one of the achievements in farm credit. It is this achievement which points the way to what may be one of the newer developments in farm credit among banks and Production Credit Associations, namely, the development of the "farm management" loan (cf. Chapters 13, 15, and 16).

<u>Evaluation of institutions for operating credit.</u> Farmers are well supplied with operating credit institutions. Commercial banks which offer checking account services and a variety of other banking facilities in addition to loans top the list in number of units and in amount of credit provided. Production Credit Associations which cover the entire country are in a position through their Federal Intermediate Credit Banks—which they are in the process of taking over—to provide a

relatively continuous source of operating credit, and especially to serve when commercial banks for one reason or another are unable to provide farmers with the credit they need. The PCA's, which are cooperatives, offer the farmer an opportunity to participate in a credit organization to supply his own operating capital. Finally, for those farmers not able to get credit at either a bank or a PCA, the FHA is available with a short or intermediate operating loan. This is a supervised loan carrying a relatively low rate of interest. In addition, the FHA provides emergency and disaster loans. But most important, the FHA has demonstrated with its operating loans the successful use of supervision in making loans to farmers whose credit rating is below that accepted by commercial banks and PCA's.

Real Estate Credit Institutions

Insurance companies, Federal Land Banks, commercial banks, and the Farmers Home Administration, in this order, are the principal real estate mortgage lenders on agricultural land. The record of these agencies in the holding of farm mortgage loans is presented in Table 11.4.

Table 11.4. Farm Mortgage Holdings of Major Institutions Making Loans to Farmers on January 1, in Selected Years

Credit Institutions	1939	1946	1953	1960
		(million dollars)		
Insurance Companies	983	892	1,716	2,834
Federal Land Banks	2,863	1,319	1,095	2,357
Commercial Banks	519	508	1,105	1,638
Farmers Home Administration	10	185	268	449
Total	4,375	2,904	4,184	7,278
		(percent of total)		
Insurance Companies	23	31	41	39
Federal Land Banks	65	45	26	32
Commercial Banks	12	17	26	23
Farmers Home Administration	--	6	7	6
Total	100	100	100	100

Source: Based on data from Agricultural Research Service, USDA.

Insurance companies have increased their farm mortgage holdings almost three times since 1939. Since 1946 they have more than tripled their holdings. On the other hand, the Federal Land Banks have a smaller total than in 1939, but they have more than doubled their holdings since 1953. Commercial banks, like insurance companies, have more than tripled their holdings since 1946.

The Federal Land Banks came out of the 1930's with large holdings of farm mortgages because other lenders were not interested or were unable to lend extensively on farm real estate. Although Federal Land Banks do not have any government capital, they do have a public responsibility in the farm mortgage field (cf. Chapter 17). Congress created these banks to lend solely on farm real estate, provided the original capital, and gave them generous financial support during the 1930's. If farmers should meet serious financial troubles again, Congress would undoubtedly see that the Federal Land Banks had the necessary support to keep farm mortgage credit flowing to deserving farmers.

On the other hand, insurance companies adjust their investments in farm mortgages not to the needs of the farmers but to the current investment policies of their companies. If they have large sums to invest and want more farm mortgages in their portfolios, they may expand their farm loans. But if they are short of investment funds or decide they want fewer farm mortgages, they may stop making farm loans, i.e., they have no obligation to make farm loans. However, insurance companies have been an excellent source of farm mortgage credit over the years, especially in the Midwest where large low-risk loans are available. Competition between insurance companies and other lenders for farm mortgage business has been of distinct advantage to farmers in areas where insurance companies have actively sought loans.

Commercial banks are in somewhat the same situation as insurance companies. Their major responsibility, as noted previously, is to their depositors, secondarily to their short-term borrowers, and lastly to long-term borrowers—and this is as it should be.

Another group of lenders, not shown in Table 11.4, are former farm owner-sellers who in the sale of their farms take a farm mortgage from the buyer as major payment for the farm. These lenders provide a valuable and outstanding service because they are able to adjust their terms to accommodate buyers. Many a farm buyer would not have been able to make the purchase had it not been for a seller who could lend a larger percentage of the purchase price than the insurance companies, Federal Land Bank, or commercial banks would lend. As for the FHA, there are limits on the funds it has available for direct loans, and in addition there are restrictions on the total amount it can lend to any one buyer, which prevents it from serving more than a small number of tenant purchasers.

The Farmers Home Administration, however, does provide an unusually fine loan service for the relatively few tenant buyers it is able to handle. As is evident in Table 11.4, it has been holding its own in extending about 6 percent of all the farm mortgage credit granted by major agencies. The FHA has set up a supervised purchase plan for both direct and indirect insured farm-ownership loans that has turned out to be much more successful than many expected. With the FHA making direct loans up to 100 percent and insured loans up to 90 percent of the purchase price, there were many predictions of failure for this high risk program in its early years. Two major policies, however, prevented these predictions from becoming fact. One was a limitation on the funds for the 100 percent loans. With this restriction, the FHA was able to select those most likely to succeed from a large number of applicants. Secondly, the FHA held the appraisal and automatically the purchase price of the farm at a figure which was justified in terms of the estimated earning power of the farm.

Evaluation of farm mortgage institutions. Here and in previous chapters it has been demonstrated that farmers are well supplied with farm mortgage agencies. The situation is much like that in the operating credit field with one agency which can keep going in an emergency. In the operating credit field, it is the PCA, and in the farm mortgage field, it is the Federal Land Bank. Federal Land Banks, like PCA's, are not government agencies, but they were set up by Congress to cover the entire country and to provide credit at all times, especially during critical periods when other lenders are not able to satisfy all legitimate credit requests.

Insurance companies, the largest lenders in the field, are a good source of competition even though they do not have an obligation or responsibility of providing continuous service in any area. The Farmers Home Administration provides a relatively small amount of farm mortgage credit, but it has been successful in this area with capable tenant buyers.

LOAN SERVICE

The big question in short- and intermediate-term lending is how to make "farm management" loans. There are still too many loans made to farmers strictly on a security basis. If the farmer has the livestock, the feed, the equipment, the lease, or the equity in his farm, he gets the loan. A "farm management" loan, on the other hand, is designed specifically to raise the income level of the farmer (cf. Chapters 13 and 15). It is made only after an intensive study of the farmer's organization and operations. The farmer may apply for a $3,000 loan for operating expenses, but after a mutual study of the business by the lender and farmer, a program may be agreed upon which calls for a total budget loan of $4,000 to expand a livestock enterprise and a fertilizer program, and to carry out reorganization of the cropping system.

The new techniques in linear programming, along with increased emphasis on farm records, should be tied in with farm lending. Just as the budget loan has been recognized as a big advance since 1935, so it is possible that the farm management loan will become one of the new developments of the sixties.

In the long-term credit area there is a similar need for farm management lending. The farmer who wants to buy an adjoining tract to add to his farm should have an analysis made before making the decision. Similarly, a prospective farm owner who is thinking of purchasing a 200-acre unit should have a farm management analysis completed before closing the deal. In buying a farm one expects to get an abstract and have it examined to see if the title is good. Also, it is wise to have an appraisal made to see how valuable the property is. Why not invest in a farm management analysis to determine the profit possibilities of the farm as a productive unit? Diesslin examines this question in more detail in Chapter 13.

It is evident that the new farm management approach has great possibilities when tied in with credit. The first area in which this combination might develop extensively could be in specialized loans like those for fertilizer, feed, and equipment. In these specialized loans the analysis would be relatively easy, and there would be a selling agency interested in providing the service in connection with the sale of the fertilizer, feed, or equipment. Eventually all lenders should be interested in providing farm management loans since lenders as well as farmers would gain from their use.

EFFICIENCY AND LOW COST

A final consideration is the possibility of greater efficiency in getting credit to the farmer with lower cost as the result. This may sound like the reverse of the preceding section where additional analysis which would probably add to the cost was discussed. The objective here is efficiency and low cost for all types of loans. For example, we are interested in efficient low-cost farm management loans as well as low-cost renewals of well-secured real estate loans and short-term loans to hold grain in storage.

Chief concerns in this instance are volume, sources of funds, and risk. The loan agency will probably find that its costs in making loans will be closely tied to the size of the loan. This is a factor that is too often ignored. Small loans are very costly to make. Many farm credit specialists have written high-sounding phrases against high interest rates. In some instances the attacks have been justified, but in other instances if these specialists had studied the size of the loans, they would have discovered that the major reason for the high interest was the small size of the loans. The high rates for small loans that are legal in most states are in recognition of the high cost involved in making this type of loan.

The second factor is source of funds. Access to low-cost credit in the central money markets has been a major achievement beginning with the Federal Land Banks in 1917 and with the Federal Intermediate Credit Banks in 1923. This has made farm credit competitive and sensitive to credit cost changes. For example, it not only brought the low rates of the forties out to the farmer, but it also brought the high rates of 1959. In the long run this is good, giving the farmer a somewhat lower over-all credit cost than if he did not have this indirect access to the central money markets.

Third, and finally, is the risk factor. To bring this difficult feature under control, insurance is being used more extensively. Examples are the Federal Crop Insurance program, the growing practice of using life insurance tied in with all kinds of loans, and insured farm mortgage loans by the Farmers Home Administration. Farm credit in the past has often been denied because of the risk involved. However, the fact is being more widely accepted that the pooling of risks can be handled efficiently and economically by insurance. In the future this technique will undoubtedly be expanded greatly to make credit available where it is not available now, and it may be used in cases where it is now too expensive to make loans. One of the opportunities for insurance may be that of small loans where some form of insurance may be substituted for much costly time and travel. What losses do occur with these small loans would be covered by a small insurance fee. In all probability the major attack on loan cost will be, as it has been in industry and merchandising, in cutting down on labor and using it more efficiently.