Chapter 17

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Farm Credit Administration

Adequacy of Our Agricultural Credit Structure

MOST OF THE DISAGREEMENTS over agricultural credit in this country stem from differences in interpretation of the word "adequate." The most commonly accepted definition of adequate seems to be "sufficient for some specific requirement." This definition doesn't help much. The approach to be used here in appraising the adequacy of agricultural credit is to consider its relevance to public policy. The test should be whether or not credit practice implements or impedes public policy.

An attempt is made to analyze broadly our agricultural policy in this country with a view to testing credit performance in the light of that policy. It has not been possible to reduce the many aspects of our public policy for agriculture into an integrated whole against which to attempt to evaluate credit adequacy. Therefore, the author has undertaken an appraisal of a very fundamental aspect of the broad national policy.

The Employment Act of 1946, in its preamble, emphasized the objective of full, useful employment of human resources in a manner that will tend to maximize the production of goods and services that society most wants at any given time, and to do this in a manner which will be consistent with encouraging economic growth, stability, and the free enterprise system. Applying this policy to agriculture is interpreted to mean for the future (1) probably considerable decrease in the total number of farms, (2) definitely fewer but larger commercial family farms, (3) probably a considerable increase in part-time farms as industry expands more into rural areas, and (4) drastic reduction in subsistence farms over time, down to what may be considered a practical minimum.

The first three of these four trends have been in evidence for some time and may continue, even at an accelerated rate, during the decade of the 1960's. The fourth, however, is occurring slowly and the reduction in number to a practical minimum will not just happen. It must be part of a very specific policy which is adequately implemented.

SOME CONCEPTS OF ADEQUACY OF AGRICULTURAL CREDIT

There are two extreme views encountered in evaluating the adequacy of agricultural credit. One of these extremes is involved in the recommendation that credit be rationed as a means of controlling agricultural surpluses. This may involve a recommendation that credit generally to agriculture be restricted, or that it be restricted to the producers of specific commodities which at a given time appear to be in surplus. There are some, if not many, fallacies and problems involved in this point of view. In the cooperative Farm Credit System, the lender's decision in each individual case is considered to be the most practical means of allocating agricultural credit as a resource.

The other extreme is held by those who seem to believe that agricultural credit is not adequate unless it is made available to all who wish to farm in the amount they need, or believe they need, and on very favorable terms. This extreme is mentioned because it is not uncommon, in spite of being in conflict with the objective of efficient utilization of our human resources. It persists because so many people were reared on farms and have a nostalgia with regard to farm life, and they find it difficult to accept the economic realities which require fewer and fewer families in primary agricultural production.

Although this chapter deals with appraising the structure of agricultural credit, it is not the intent here to deal that narrowly with the subject. A meaningful appraisal can be made only in terms of performance. Structure is only one factor involved in performance; more important are the people who extend credit. Their ability, training, experience, and attitude largely determine the performance.

Since colonial times the emphasis in the United States has been upon achieving efficiency of the human factor of production. This has involved associating increasing amounts of capital (including land) with a given amount of labor. Certainly the most important aspect of the agricultural revolution since the beginning of World War II has been the substitution of capital for labor in agriculture (Chapters 6 and 7). During the decade of the 1940's a high proportion of this capital accumulation was financed by farm earnings. However, during much of the decade of the 1950's a considerably higher proportion was financed by credit (Chapter 11). A fair test of the agricultural credit structure lies in the fact that it permitted farmers to increase their borrowings during the postwar adjustment of the 1950's from 10.8 billion to 22.6 billions of dollars. This test becomes even more significant considering the fact that during much of this period the demand for capital was tremendous and credit stringency existed. The agricultural credit structure permitted farmers to compete successfully with commerce and industry for limited capital funds.

WILL THE FUTURE REQUIRE LOW EQUITY FINANCING FOR AGRICULTURE?

Credit will play an increasingly important role in agriculture during the 1960's. It will take a great deal of credit to finance the innovations and adjustments which are essential for still greater efficiency in production. Integrated operations are likely to become more prevalent. Credit may be an important factor in connection with some of these operations. If integration develops to the extent that some people visualize, it could greatly alter the structure for agricultural credit.

Much has been written about the success some farmers have had in contract farming with the integrator furnishing most of the capital. These successes sometimes are cited as evidence that farmers can succeed even though they have a small equity in their operations. This conclusion is not warranted. In the first place, the integrator himself must have a good equity in the undertaking. Furthermore, he has the advantage of decision making, control, and often other advantages which a lender could not hope to have (Chapter 8). The success of a family operating under contract is not comparable with one borrowing on a thin equity.

For the greater part of a generation now, urban homes have been quite successfully financed with low owner equities. Does it follow that a parallel program of low owner-equity financing of farm real estate would be equally successful? There seems to be a growing number of people who believe that it might. Such a situation is basically different. For instance, the city family is not required to invest each year a substantial amount of operating funds which may be two or three times as much as the net income it may reasonably expect from employment. Yet, this is precisely what the farm family does each year, and certainly the risk involved is substantial.

The success of the Farmers Home Administration and its predecessor agencies in making low equity mortgage loans for farm purchase and improvement from 1935 to 1960 is cited as further evidence. Also cited is the relatively favorable experience with the 75 percent Commissioner loans made from 1933 to 1946. Both of these programs were started when farm income was extremely low and the farm real estate market was at a very low point. These two programs were of great value to agriculture, but much of the success of both was due to a rising level of farm earnings — in fact, involving many years of really good earnings — and with it, a rising land market. These factors are not expected to be anywhere near as favorable in the 1960's.

Perhaps the most popular appeal for low equity financing is to help young people who were reared on farms remain in agriculture and achieve the status of owner-operators. The White House Conference on Children and Youth was held during the last week of March, 1960. A press release issued in connection with this conference dated March 2, 1960, stated: "We already know that, with scientific advances which reduce the need for manpower, less than 15 percent of the young people growing up on farms today will stay there in an ownership or managerial capacity." This statement, made by a high-ranking government official, is quite realistic. The author, having been reared on a farm and being a bit of an agricultural fundamentalist, is reluctant to accept this conclusion, although the facts point that way.

Most of these 15 percent will inherit farms through family or marriage. Others will receive substantial help from relatives, which always has been an important part of farm financing. Some will resort to part-time farming, which is a relatively new rung in the agricultural ladder. To encourage a larger proportion of young people to stay in agriculture by extending them credit equivalent to a very high proportion of their total capital needs would be a distinct disservice to them, to say nothing of being contrary to a policy of efficient resource use.

The author's conclusions on the matter of low equity financing for commercial family farmers are as follows:

1. It might be justified if, as a matter of national policy, it were decided to encourage more people to remain on farms. This, however, is not the case.

2. Agricultural income outlook for the 1960's does not encourage one to believe that low equity financing would be sound.

3. The aggregate equity of American farmers in their farms is very high — approximately 88 percent of the current market value of farm assets.

4. Since commercial family farms may be reduced substantially in the 1960's, there should be available a higher proportion of farmers than ever before with demonstrated managerial ability. The consolidation of farming units should largely be done by these people, and especially by those who have a combination of demonstrated managerial ability and substantial equities in their present farm holdings. The land ownership adjustments should emphasize keeping farms in strong hands which are most likely to succeed in the highly competitive situation that lies ahead.

5. Over-lending is a great disservice to farm families. If real estate loans are made representing substantially more than traditional lending ratios, what relief can be made available when deflation takes place? With the high agricultural productive capacity that exists in the United States, prices for farm land will not continue the trend upward indefinitely. As a matter of fact, some reduction in land prices is already overdue.

These conclusions with regard to financing family-type farms in commercial agricultural areas may seem harsh. The author believes, however, that they are in the interest of farm people and the nation generally. A somewhat different view is held with regard to the matter of credit needs in chronically low-income agricultural areas. It has been demonstrated that adjustment in these areas takes place very slowly unless special assistance is given. There is no question but that low equity financing of the better qualified farmers in these areas, coupled with supervision and technical assistance, is necessary to achieving consolidation, development, and adjustment. This would seem to be primarily a job for government credit.

FINANCIAL STRUCTURE

To present a discussion more pertinent to the subject of this chapter will require giving some approximate answers to the question: Will the financial structure of lenders permit the expansion of agricultural credit that likely will be needed to finance the adjustments and innovations that seem a certainty for the 1960's? This question will be approached from the standpoint of institutional lenders.

Commercial Banks

Commercial banks have been the largest suppliers of agricultural credit in the past, and undoubtedly they will continue to be for the foreseeable future (Chapters 3, 5, and 11-13). Governor Shepardson comments with respect to them in Chapter 18.

Farmers Home Administration

The Farmers Home Administration is not particularly handicapped from a structural standpoint except, perhaps, in the matter of some unrealistic interest ceilings. Its performance is influenced periodically by both executive and legislative interpretations of policy and necessary implementation.

Cooperative Farm Credit System

This system has built up a total net worth exceeding 1.2 billions of dollars by 1960. Of this, 18 percent is represented by government capital, 28 percent by farmers' capital, and 54 percent by earned net worth. In addition to this capital structure, the Banks for Cooperatives, the Intermediate Credit Banks, and the Production Credit Associations have access to certain revolving funds which may be made available by the Treasury if loan demands require it from a ratio standpoint.

The Federal Land Banks would be able approximately to double their 2.4 billions of dollars of real estate mortgage loans if necessary.

The Banks for Cooperatives have a capital structure which would permit them to more than double their lending volume. Farmer cooperatives are expected to play an increasingly important role, especially as integrators and as bargaining agents for farmers. They will have need for larger amounts of credit.

Production Credit Associations have a capital structure which, taken with revolving funds that could be made available to them, would permit a doubling of their loan volume.

The Federal Intermediate Credit Banks, which have had a very rapid growth in loan volume since 1955, would not be able to double their volume of business unless additional capital were made available for ratio purposes.

SOME OBSERVATIONS ON THE COOPERATIVE CREDIT SYSTEM

The cooperative Farm Credit System has decentralized its operations to a great extent. It has also experienced a very rapid growth in loan volume which has increased by approximately 105 percent since 1954, reaching a peak of $4 billion in 1959. This was during a time of considerable money stringency, a period in which the system proved itself capable of competing for funds in the capital markets. As a matter of fact, some of this increase in volume occurred because competing lenders were short of funds or chose more profitable nonagricultural investments. This period has proven that the greatest value of the cooperative Farm Credit System is the dependability which it has demonstrated in making credit available to qualified borrowers at all times.

The Farm Credit System imports capital funds from urban centers rather than relying primarily on local capital for loan funds. Production Credit Associations, for instance, do not compete with local banks for deposits or other types of customer services. They are simply in the specialized business of making agricultural loans.

The purposes for which loan proceeds from the System may be used are very broad. They are not available just for farm needs. Many family needs — including housing, household equipment, and funds for education of children — have been met over the years with both Land Bank and Production Credit Association loan proceeds. There have even been instances in which loan funds were permitted to finance a family member, no longer needed on the farm, to become established in a commercial enterprise away from the farm. The Farm Credit Banks and Associations have been making reasonable adjustments to the rapidly changing agricultural situation. Some of the innovations that bear citing are:

1. Federal Land Banks

    a. More realistic loan levels. The constant problem is to maintain a balanced position. That is, the extension of loans which are sufficiently large to be helpful, but which will not unduly contribute to land market inflation.
    b. Loans to part-time farmers.
    c. Loans to family farming corporations.
    d. Loans on timberland.
    e. Complete removal of loan limits (amount that can be loaned).
    f. Five percent bond rate ceiling removed January 1, 1960.
    g. Nonamortized and partially amortized loans. Legislative authority for these types of loans was granted recently and some experimentation is to be conducted.

h. Authority to defer principal installments for periods up to five years.
i. Real estate loans in Alaska. The Federal Land Bank of Spokane has made several.

2. Banks for Cooperatives

a. Perhaps of as much importance as the money loaned has been the counseling and assistance with financial management which the Banks for Cooperatives have given to farmer cooperative associations over the years. This continues to be an important contribution.
b. Commencing in 1956, the structure of these banks was changed to provide for systematic investment in their capital by farmer cooperatives and a corresponding retirement of government capital.
c. An important innovation which some of the banks have adopted has been the interest "escalator clause" in their loans. This provision for varying the interest rate periodically with the change in cost of money to the banks has been occasioned by the rather drastic variations in mortgage interest rates in recent years.

3. Credit Banks and Production Credit Associations

a. Many changes have been made to simplify operations in these institutions. Production Credit Associations have made a major contribution to agricultural lending with the budgeted loan program which they pioneered many years ago.
b. Since their inception, Production Credit Associations have made loans to part-time farmers.
c. Intermediate-term loans have been an important part of the business of Production Credit Associations for many years. It is, however, only since 1955 that they have been making such loans based specifically on three- to five-year notes.
d. Financing purchases by patrons of supply cooperatives. In the late 1950's this program gained considerable momentum in about half the Farm Credit districts.

In the matter of structure, there is little to say by way of criticism. Considerable amending legislation since 1953 has resulted in structural improvements. If the cooperative Farm Credit System were to be initiated now with the knowledge available from experience since 1917, there would not be three separate bank systems. Possibly there would be only one, but at the most, two bank systems. One would be a Bank for Cooperatives and the other a bank lending to individual farmers for all of their operational needs.

Tools are available for doing a good, constructive, sound job. In the matter of performance, a rather wide range of accomplishments is exhibited. The Federal Land Banks often do not use a great deal of ingenuity or effort in attempting to fit loan payment terms to the needs of individual borrowers. There is too much of a tendency for a district bank to adopt either the standard (equal total installments) or Springfield (equal principal and consequently declining total installments) type of loan amortization and to stick to it for all or practically all loans, regardless of which best fits the borrower's needs. Also, the term of years for which a loan is made tends to be stereotyped by districts. There is some tendency to strive for uniformity as between annual and semiannual installment billing, rather than have it coincide with the borrower's income pattern. For years the Land Banks have had the privilege of deferring loan principal installments for as much as five years. This tool is used almost exclusively in servicing problem cases. It could often be used at the beginning of the lending period to give the borrower the opportunity to make further improvements to his real estate or add to his livestock or equipment in a manner that would immediately increase his earning position.

One can prove almost anything as to performance among the 494 Production Credit Associations. There are still a few of the "country club" type which are quite content to serve their limited number of members, that are extremely proud of their record of no losses, and which are overly obsessed with the idea of protecting their reserves. Fortunately, there are very few of these. On the other hand, there are a substantial number of Production Credit Associations that extend very constructive credit service. In between they shade both ways, but the record indicates that the majority approach the latter category. Not enough of the Production Credit Associations are jointly housed with Federal Land Bank Associations, which would facilitate a closer working relationship in the borrower's interest.

As for the Banks for Cooperatives, the author has little criticism since they presumably are making available more than 50 percent of the credit used by farmer cooperatives. Their business is characterized by generally rather large loans and the unique specialized counseling services available to cooperatives.

SOME CONCLUDING OBSERVATIONS

Our agricultural credit "complex" — made up of individuals, commercial banks, cooperative credit, and government credit — is a very desirable arrangement. These four categories have no rigid spheres of influence and tend to complement each other as well as to furnish some wholesome competition.

Most discussions of the adequacy of credit have to do with quantitative aspects. The qualitative dimension of agricultural credit is of almost equal importance, viz., the matter of counseling on farm business analysis and financial management. Most directors and managers of the Farm Credit System's associations strive to achieve this personalized constructive service. Even the most successful of these men probably are not aware that they are "rationing capital into agriculture on a marginal productivity basis," but they strive to make constructive loans which will maximize the income of the farm family and offer the best prospects of repayment.

No appraisal of the adequacy of agricultural credit would be complete without consideration being given to the probable behavior of lenders during periods when farm income is seriously squeezed. Historically, individuals extending credit to farmers are in the poorest position to grant forbearance, be they merchants, fellow farmers, or even relatives. They seldom have the resources to permit them to grant forbearance over a very long period of time.

Local banks usually retrench and tighten up on credit extension during periods of agricultural income stringency. The behavior of insurance companies under these conditions varies considerably. In case of depression they may be confronted with demands from their policyholders which will require strict collection policies.

It is the policy of the cooperative Farm Credit System to grant forbearance to borrowers who are making an honest effort but who are confronted with inadequate income due to no fault of their own. Fine demonstrations of this policy were witnessed when farmers and ranchers in the southern plains area experienced several successive years of severe drought in the early to mid-1950's. The effectiveness of such a policy was also demonstrated in the Mississippi delta area when widespread crop losses occurred due to very poor harvesting conditions in 1957 and 1958. Not since 1940 have the banks and associations generally been put to a real test. Since then their net worth position has been built up substantially, and it is assumed that they will use constructively the various types of forbearance which are legally available to them.

Certainly adjustments must be made in credit to adapt it to the needs of a dynamic agriculture, but business principles cannot be stretched very far without disservice to both borrower and lender. It is important to remember that credit can be substituted for income only within rather narrow limits and for short periods of time. It is not an enduring form of farm relief.