Remarks by Chas. N. Shepardson, Member of the Board of Governors of the Federal Reserve System at the Agricultural Clinic for the Indiana Bankers Association at Purdue University, Lafayette, Indiana, on March 13, 1963.

When Dr. Butz invited me to participate in this program, he did not assign any particular topic although he did express the hope that I would talk on some phase of agricultural credit. While this is a subject in which I have been extremely interested for many years, I hesitated for two reasons. In the first place, I understand that you have been holding these Clinics since before World War II and I am sure that, under the leadership of Dr. Butz, Dr. Diesslin, Dr. Atkinson and others who are professionals in this field, you have covered all phases of the problem many times. Secondly, and unfortunately for me, I have had little opportunity to get any first-hand knowledge of the situation in Indiana for, while my wife is a native Hoosier, I found her out in Colorado and we have never been in the State except for short visits since we were married.

Consequently, when I agreed to accept this assignment I endeavored to find out what your problems or shortcomings might be. So far, I have drawn a blank on both counts although I have talked with our agricultural economists at the Federal Reserve Bank of Chicago, with Ed Savidge, the manager of the Agricultural Commission of the American Bankers Association, and with your own Dr. Atkinson, who spent several months with us in Washington last fall. Meanwhile, Dr. Butz has told me of the fine cooperation and support that you have always given the University. That is further attested by your attendance on this occasion and the fact that so many of you have brought your county agents with you. From all of this, it would seem that you have taken past discussions and suggestions to heart and are applying them in your own operations, and that agricultural credit needs in Indiana are being well met by Indiana bankers.

I would like to believe that this is so, yet several things that I have run across recently lead me to raise some questions. First, are bankers losing their interest in agricultural credit? For example, total agricultural credit increased 65 per cent from 1955 to 1962, yet farm loans in country commercial banks increased only 52 per cent in the same period. Is this because other fields, such as consumer installment credit, are more lucrative? Is it because other agricultural lenders, including government and quasi-government agencies, are becoming more competitive? Is it because loan supervision has become too difficult with technological developments and increasing credit needs of agriculture? Is it because those needs have grown beyond the loan limits of the average country bank, or is it because some banks are failing to measure up to the A.B.A. claim of being full-service institutions?

At this point I would call your attention to the Farm Debt portion of the 1960 Sample Census of Agriculture conducted by the Bureau of the Census in cooperation with the Department of Agriculture, the Farm Credit Administration and the Federal Reserve System. I mentioned earlier that Dr. Askins spent some time at the Federal Reserve

Board in Washington last fall. It was this project on which he was working, and in the December 1962 Federal Reserve Bulletin he had the first of a series of articles which the System plans to present, analyzing various aspects of this Debt Survey. It is not my purpose to discuss this Survey at length but I do want to call attention to a few items in that article which seem to me to have a distinct bearing on some of the questions I have raised.

With reference to relative profitability of farm loans, Dr. Atkinson pointed out (1) that a large number of communities derive their basic income from farming, (2) that farm income has a multiplier effect on total community income as it moves through the supporting suppliers, processors and distributors of farm products, which constitute a significant if not major share of the business activity of most of our towns and smaller cities, and (3) that credit has become an indispensable production tool of most farmers. I mention these facts only to remind us that, even though some other types of loans may be more lucrative than farm loans, we cannot afford to neglect the latter since they provide the basis for the others in most communities.

What about the competition of other lenders, more especially government or government-sponsored agencies? We frequently hear complaints about the continuing encroachment of government in business but we should never forget that nature abhors a vacuum. If there are unfilled credit needs in any area, we should not be surprised if government moves in to fill the need. For example, we all know that many bankers have welcomed the opportunity to refer less creditworthy and more troublesome borrowers to the Farmers Home Administration. We also know that it is the intended purpose of that agency to assist such borrowers and, through training and supervision, to build them up to creditworthy status and then graduate them to borrowing from a commercial lender. Yet, we frequently hear complaints that this or other government-sponsored agencies are failing to graduate or are actually soliciting creditworthy borrowers on the basis of preferential rates, terms, or other services. Knowing the tendency of most of us to want to build the institutions on which our own jobs depend, it should not be surprising if such instances occur from time to time even in the face of announced policy and instructions to the contrary. I suggest that the best way to deal with such competition, actual or prospective, may be through more aggressive efforts on our part to develop ways of meeting these needs within the framework of sound commercial methods. This may even mean encouraging and assisting the would-be borrower to get into a more promising field of activity.

This brings me to the problem of farm loan supervision and the question of whether its increasing complexity may be the reason for some banks turning away from the problem and toward other types of loans that may seem easier to handle. In this connection, it is encouraging to note the number of larger country banks that have employed farm representatives specially trained to handle this phase of their activity. My concern is with two other types of banks, namely the small country bank which feels that it cannot afford a trained specialist in this field, and, second, the city bank which feels that it has little or no demand for, or interest in, farm loans.

There is no question about the fact that technological advances and increases in the size of farm units have added to the size and complexity of farm credit needs. For example, in the Debt Survey referred to earlier, it was found that 600,000 farmers, comprising approximately three-fourths of the farmers with annual sales of $10,000 or more and nearly one-fifth of all farmers, had total debts averaging nearly $11,000 for the Class III, or $10,000 to $20,000 sales group, $18,000 for the Class II, or $20,000 to $40,000 group, and $49,000 for the Class I, or over $40,000 group. Obviously, the credit requirements of many of these farmers run well beyond the loan limits of many of our smaller country banks and possibly beyond their ability to handle.

This would seem to indicate a real opportunity for city banks which profess to have few, if any, direct farm loans and yet profess to have a real interest in servicing the needs of their smaller country correspondents. These city banks could themselves develop strong agricultural departments. Such departments could render a real service in analyzing the operations and credit needs of those larger customers of their country correspondents, setting up loan plans for them and then agreeing to participate in the fulfillment of those plans to the extent that the local bank might desire. Incidentally, some city banks have found this type of relationship to be a source of some profitable trust and management accounts. In some cases they have even generated enough business for the trust department to more than offset the cost of the farm department.

However, the lack of interest in farm credit on the part of many city banks would seem to indicate that they, too, lack an appreciation of the ramifications of agriculture in our economy. Yet the interdependence of the producer in the country and of the supplier, processor and distributor of farm products in the city fully justifies greater attention by city banks to the credit needs of the producer whose activities represent the foundation on which these other phases of agriculture are based.

This brings me to the question of full-service institutions. The Debt Survey, referred to earlier, showed that farmers with both real estate and non-real estate debt seldom used banks as the major source of both types of credit. For example, farmers who used banks as a major source of real estate loans had an average total bank debt of about $7,000, of which only about $500 was non-real estate debt, while they owed other lenders an average of about $2,000, mostly for non-real estate debt. The reverse was true when farmers used banks as the major source of non-real estate loans.

There has been much discussion about banks as full-service institutions and about one-stop servicing either through their own resources or through auxiliary arrangements with correspondents and life insurance companies. So far as farmers are concerned, however, little progress appears to have been made. While it is generally recognized that the credit needs of the average farmer probably could be served better and more economically through one rather than multiple credit sources, there seems to be abundant opportunity for further development of the single-source type of service.

There is one other question that I would like to raise with you. This has to do with the basis used for extending farm credit. There was a time when farming was largely a "way of life." Production processes were simple, purchased in-puts were few; power, both man-power and horsepower, and the fuel for both were largely home-raised; cash income was small but so were needs for cash and consequently for credit; and a farmer's creditworthiness was based largely on his collateral, real estate for long term, barnyard for short term, and on his character, including his industriousness. Today the situation is far more complex. Farms are increasing in size. The development of new agricultural chemicals and their use in animal nutrition and as fertilizers, herbicides and insecticides goes on daily, production processes become more complex; hand labor has decreased; horse power has almost vanished; and power units and their fuel represent almost 100 per cent purchased in-puts. As a result, farming has changed from a "way of life" to a highly complex business with a greatly increased cash flow and a corresponding expansion in credit needs. All of this has also raised the personal requirements of a potential borrower to include not only good character and a reputation for work but also a high degree of technical skill and business acumen which can best be determined by a careful analysis of his plan of operation and his operating statement. This analysis should also include an analysis of his cash flow since, with the ever increasing investment in equipment on our largerfarms, the depreciation charges become a real source of funds to be taken into account in assessing repayment capacity.

In saying this, I am assuming that a sound farm loan, like a sound business loan, is one that will produce sufficient additional income to cover its repayment and, hopefully, some profit to the borrower. For this reason I have been amazed to hear both bankers and business men say, within the last two years, that they are just beginning to examine operating statements as well as collateral in passing on loan applications. In the Debt Survey mentioned earlier, Dr. Atkinson found that, while three-fourths of the farmers reporting debt owed less than $10,000, their average income from sale of farm products was less than $2,400, obviously providing little if any margin over living expenses and capital maintenance for repayment of debt.

From other information available, it appears that this group of borrowers might reasonably be divided into three categories. One represents the elderly farmer who has not been able to keep up with advancing technology, who sees or desires no alternative occupation at his age, and who is frankly planning on a gradual liquidation of his assets as a supplementary source of living expense. This group would seem to be fully justified if they desire to follow such a plan although the lender should understand the situation and realize that this is apt to be a slow loan with liquidation as the ultimate source of repayment.

The second group represents the younger farmer who lacks the technical skill or business acumen to be a successful farmer and who is wearing himself and his family out on a basically unsound enterprise that will ultimately absorb his equity through attrition of a losing operation. In some cases even part-time, off-farm employment is insufficient to offset his operating losses. Many in this group might well be denied credit and advised to seek full-time employment in some other field and to sell or lease their land before their losses eat up their equity.

The third group represents the new young farmer whose training and experience give promise of the ability to manage a successful farming operation but who lacks adequate resources. Not infrequently such an individual, in an effort to build up his resources, is spending time in off-farm employment that might be spent more profitably in a larger operation of his own. Or he may be wasting himself and his talents with what he knows to be antiquated or inadequate methods or equipment. Here again, earning potential is more important than collateral as a basis for a loan, and some banks, including a few that I have heard of in this area, have found it profitable to set aside some funds each year for loans to promising young farmers on a basis that might technically be subject to criticism but that practically are proving to be sound loans and a means of developing some good customers.

What I have tried to say is that through too great a reliance on collateral and through inadequate attention to analysis of operation and the borrower's capabilities, banks may be extending credit in some cases where it is not warranted, while denying it in other cases where it is, and ultimately losing present and potential customers both ways. While this portion of my remarks has been directed primarily to the problem of the smaller borrower, I am convinced that the need for analysis of plan of operation, profit and loss statements and cash flow is of even more importance in the case of larger borrowers with credit needs ranging up to $50,000 and higher. So far as the smaller country bank is concerned, this is a need that can best be met with the assistance of the adequately staffed agricultural departments of a larger bank and more of our city banks should be alert to the opportunity that lies in providing this type of service, thus helping to maintain our country banks as viable units in their home communities.

In closing, let me remind you that growth involves change -- changing needs, changing methods, and changing opportunities. This applies to the entire economy, including farmers, bankers, and businessmen in general; yes, even to our schools and colleges. Unless we are constantly alert to changing needs and to the development of changing methods or tools for meeting these needs, we may face the further encroachment of government and the loss of opportunity to share in the benefits of growth. We may even face the loss of opportunity to run our own business unless we constantly maintain that spirit of initiative and self-reliance characteristic of the free enterprise system that has been the mainstay of our growth and development in the past and will continue to be in the future. I congratulate you on your accomplishments of the past. I challenge you to even further efforts in meeting the changing needs of the future.