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# Financing Rural Economies and Agriculture

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# Financing Rural Economies and Agriculture

In appearing at this Farm Forum to talk about financing rural economies and agriculture, I do so without the pretense that I know more than my audience about most aspects of farm and rural finance. Many of you must be intimately involved in rural credit, either as borrowers or lenders, and some no doubt as both. So while the title of my talk looks general enough to cover just about anything, I'm going to avoid topics where I think your expertise outclasses mine and focus on aspects where my credentials are in better order.

Generally I will be characterizing the operation of our financial institutions, and the channels through which capital and credit flows to various economic sectors, including agriculture. One might infer from the data on the recent growth in farm debt that present financial arrangements have been effective in providing adequate rural credit. However, I would not come to that judgment unless growth in the use of credit were gauged in terms of growth in need. And the inference may be questionable because there are some characteristics of our financial institutions and certain prevailing financial practices which obviously impede the flow of rural credit. These arrangements in the private sector may only amount to adversely affecting the allocation of private credit to rural areas, any shortfall being offset by expanding Federal credit programs for rural areas. But adding to the problems to be solved by Government, those that might be solved or ameliorated by a better functioning of private institutions and arrangements hardly seems an optimum policy stance.

I wish to acknowledge the assistance of Emanuel Melichar, Senior Economist, Business Conditions Section of our Division of Research and Statistics, in the preparation of material for this paper.

I want to make clear the nature of my critique of private institutions. I am going to be dealing with the organizational framework--the financial laws, institutions, and practices--within which rural lenders operate. To a large extent, lenders themselves appear to be operating efficiently; efficiently, that is, within the limits allowed by prevailing practices and institutional structure. But the present setup has defects that impose significant disadvantages on institutions and their customers. Banks, for example, are often popularly blamed for lack of lenders' initiative or avoidance of the effort needed to make rural loans when they may, in fact, be partly or largely immobilized by internal constraints within the system. If we can find the faults and improve the system--if, for instance, we can change things so that rural financial institutions can make more efficient use of their present resources, or so that they can improve their access to the nation's main market flows of funds--then the rural economy will be the winner, at least to the extent its needs are competitive with other demands on the economy's credit resources. This result is also likely to be in the long-run benefit of rural financial institutions.

## The Financial Mechanism

Basically, we are concerned with the process by which the nation's savings get allocated along various investment sectors, one of which is the rural economy. The nation continually generates a flow of savings; one part of the flow is directly invested by the saver--plowed back into his enterprise; another part is deposited in banks or thrift institutions, who then lend it out, generally to their own customers, or make it available in central capital markets; and the third major part is directly made available in central capital markets, where it may be purchased either by users or by banks and other financial institutions who then lend it at the most favorable terms and rates available. This financial mechanism, if operating efficiently, directs funds to the uses that promise the best return after discount for risk and uncertainty and taking into account lenders' preferences for terms of repayment.

The financial mechanism serving rural areas has two arms--the private institutions and the Federally-sponsored institutions. This ambidextrous characteristic is not unique to rural investment, but is a feature of many other aspects of our economic life where private flows of funds are not large enough to satisfy social objectives. Housing, urban redevelopment, education, export financing, are illustrative of activities aided by public intervention. Conceptually, one might say, public policy acting through Government may institute a Federal credit program only when imperfections in the working of the private financial sector are causing a suboptimal allocation of funds to a given activity, or when it is socially desirable to encourage the expansion of that activity beyond the limits of an efficiently working market system.

Take, for example, the financing of farm investment and operations. The credit program serving marginal farm borrowers--the Farmers Home Administration--can be viewed as having been established primarily on considerations of social desirability, serving mainly farmers who would be fairly unlikely to secure very much credit even with an efficiently functioning private credit market. On the other hand, it seems unlikely that the Federal credit program serving commercial agriculture--the cooperative Farm Credit System consisting of the Federal Land Banks, production credit associations, and the Banks for Cooperatives--was initially undertaken or periodically expanded primarily in order to expand farm output. A better rationale, in addition to political considerations, is that the private financial sector serving rural areas was and is sufficiently imperfect so that farm borrowers were and are at a significant disadvantage when competing with other economic sectors for funds in national credit markets. These Federal credit programs played a very significant role in meeting the unprecedented credit demands that arose in the agricultural sector during the last two decades.

That record is worth taking a look at, especially with the perspectives afforded by some recent studies made by Federal Reserve Board staff. Data on agricultural finance go back to about 1870. The most striking financial fact about most of this period--during which the West was settled and farming was extensively mechanized--is not the large amount of credit used, but rather how little was used. Most capital requirements were met directly through farmers' savings. There was only one brief period during which borrowings rose sharply and exceeded the amount of internal financing, and that was during the land speculation boom that accompanied World War I. As many can still personally remember, disaster followed quickly for many of these borrowers when farm product and land prices collapsed after the war.

The recovery from this episode was prolonged by the Great Depression, and the events together brought into being the Federal credit programs for agriculture. But no borrowing spree resulted; on the contrary, outstanding farm debt was gradually reduced through a combination of foreclosures and little new capital spending. Then in the second World War, farmers adopted a different economic strategy from that in the previous war. As they prospered they saved much of their income, and reduced their debt to a low of $8 billion in 1946. After the war they financed enormous building and equipment purchases, mainly from their wartime savings plus their continued high income.

Toward the mid-1950's, farm finance trends appeared to be settling down. Annual farm capital spending had leveled out at about one-third of farmers' total cash flow. Farmers were financing 88 per cent of this spending internally, from their cash flow, and only 12 per cent through increasing their debt. The internal financing took about 27 per cent of cash flow. Farm debt was rising by about $1 billion annually.

Viewed historically, this high proportion of internal financing looked like normal farm financial behavior. But during the late 1950's a significant change occurred; farmers collectively reduced their savings rate to a level which still prevails. Savings dropped from 27 to 22 per cent of cash flow. Consequently, internal financing met only two-thirds of capital requirements, and debt financing rose to one-third. Thus, even though capital spending did not rise, average annual increases in outstanding farm debt rose to over $2 billion.

The new lower savings rate continued through the next capital spending boom, which occurred in the mid-1960's. Consequently, in these years, annual increases in farmers' debt rose to over $4 billion. More recently, increases in debt have moderated about in line with reductions in capital spending and reduced activity in the farm real estate market, so that the reduced savings rate apparently continues.

Will the unprecedentedly high and sustained reliance on debt financing of recent years wane or persist? Emil Melichar, Agricultural Economist for the Board, has suggested a line of analyses responsive to this question. On the one hand, he notes that the postwar demand for credit appears associated with the rapid reorganization of farming into larger units. For the first 40 years of this century there was very little change in the size of the average American farm, but the postwar enlargement of farms has coincided with the rapid rise in debt. Another factor noted is that the postwar land price inflation which, in addition to raising capital requirements involved in land transfers, may have increased credit demands by making some farmers wealthier in terms of assets than in terms of current income. Still other influences raising credit demands are a higher proportion of nonfarm heirs and an increased propensity for farmers to elect a retirement period, for which they must cash in their farm assets. Such trends will probably continue.

The second aspect of the farm finance record of the last two decades, Mr. Melichar notes, is perhaps self-evident: namely, the ability of farmers to raise these unprecedented amounts of funds in credit markets. From the low point of $8 billion in 1946, outstanding farm debt rose to $24.8 billion by 1960 and now stands at $65.6 billion. For most commercial farmers the need to incur additional debt happily largely coincided with the ability to do so; consequently, reports over most of the period of rapid debt expansion usually noted that the supply of credit was adequate, and that farm credit needs were being met.

This record was only achieved, however, because of the sizable borrowing from sellers of farms, from farm suppliers, and directly in capital markets through the Federal credit programs. During the last 10 years (ending January 1, 1971), Federal credit programs accounted for $10.8 billion, or 30 per cent of the total increase in farm debt. Another $6.9 billion increase in real estate debt was obtained mainly from sellers of farms--a source that was especially significant in tight money years. Farm suppliers, particularly during the machinery buying boom of the mid-1960's, were an important credit source which used access to money markets directly or borrowed from large non-agricultural banks. Non-real-estate debt owed to suppliers, dealers, and individuals increased by $7.3 billion. Life insurance companies increased their farm mortgage debt holdings by $2.6 billion.

Private financing versus Federally-sponsored credit

Over the very long view, agriculture has always been financed by individuals, suppliers, insurance companies, and banks, with banks historically the dominant institutional credit source. The new element on the scene is the Federally-sponsored credit. These programs exhibited faster growth in credit extension than did other sources over the last decade. They seem to have been needed. Private lending institutions added $5.4 billion to their farm mortgage portfolios in the past decade. Could they have supplied the additional $6.4 billion in farm mortgage debt provided by Federal Land Banks and the Farmers Home Administration? Or could commercial banks have provided the $4.3 billion rise in non-real-estate debt secured from production credit associations and the FHA in addition to the $6.1 billion they did extend?

There is evidence that banks have been hard put to provide the farm credit increase that they actually recorded in the past two decades. In 1950, farmers' bank deposits totaled $6.6 billion and their farm loans from banks stood at $3.0 billion, or 45 per cent of their deposits. On average, farm loan demand could be viewed as being met through lending out deposits of the same or other farmers. By 1971, however, farmers' bank deposits totaled $10.4 billion whereas their bank loans had risen to $16.2 billion, over 150 per cent of their deposits. Banks are thus far from being able to finance agriculture from farming's own contribution to growth in banking resources.

Another farm finance problem involving banks is that the reorganization of farming into larger units has enlarged individual farm credit beyond the capacity of individual banking institutions, especially in those States where banking has not undergone a parallel reorganization.

With respect to the rural nonfarm economy, statistics on the performance of the private financial sector relative to credit demands are limited. There are, however, some clues. Since 1962, when the Farmers Home Administration was put into the business of financing nonfarm rural housing, its outstanding loans for this purpose have risen to $3.4 billion. Over the same period, outstanding FHA loans for sewer and water systems, recreational development, and similar nonfarm enterprises have risen from $12 million to $970 million. These are significant sums to have been lent over so short a period, and it seems doubtful that very much of this credit demand would have been met by the private sector.

Another indication of rural credit needs can be derived from the apparent rise in the number of people who insist that Federal credit programs should be extended to other segments of the nonfarm rural economy. For instance, in 1970 the President's Task Force on Rural Development called for creation of a Rural Development Credit Bank as a new part of the cooperative Farm Credit System, and for expansion of the nonfarm lending activities of the Farmers Home Administration. Since then, the Farm Credit System has obtained some nonfarm lending authority, but declined to seek expansion on this scale into nonfarm lending. However, several bills that purport to accomplish this in one way or another have been introduced in Congress, and hearings have been held on some of them.

In July 1971, the President's First Annual Report on Financial Assistance to Rural Areas stated that the principal rural sector requiring additional Federal financial assistance was the state and local government sector, and thus the message reiterated the previously proposed rural revenue sharing plan. With respect to nonfarm business, the message argued that while the efficiency of the existing credit programs of the Small Business Administration and the Economic Development Act could be improved, "new initiatives in providing financial assistance in support of rural development should place major reliance upon private sector lending institutions." But in the latest presidential rural message of February 1, 1972, the Administration altered this view to the extent of proposing a Rural Development Credit Fund that would be administered jointly by State governments and the Farmers Home Administration. Given this step by the Administration and the substantial congressional support evidenced for various rural development measures, the enactment of some kind of new Federal credit program intended specifically to assist in the financing of rural businesses, industries, and public services may be regarded as probable.

Making the private sector work better

As noted, the Administration and many other backers of expanded rural development credit have expressed a philosophical preference for private sector financing. There are sound economic reasons for this, mainly in the quickness and flexibility of response to particular situations. For instance, the private sector can usually deal more effectively with novel credit demands or those that are unique to certain regions, or those that may require some departure from traditional terms or financing methods. However, those persons who prefer private credit, and who at the same time believe that private credit allocation to rural areas has been suboptimal, have often dealt only with superficial aspects of the situation. Thus many apparently think, for example, that bankers need only to be exhorted to "do a better job of farm lending," to "take more interest in farm lending," or to "make more use of their correspondents." A typical plea was that of the President's Task Force on Rural Development, which said, "we recommend a special effort by banks, financial institutions, and the SBA to lend money...[to] small businesses in countryside America." But nowhere did the Task Force undertake to determine why bankers now run their banks the way they do, and what institutional changes might permit or encourage them to expand lending of the type desired. Thus, without investigating what might be done to permit more or all of the prospective rural development credit demands to be met by the private sector, or recommending that someone else undertake to determine this, the Task Force merely noted that "the capital needs... are too great in total, and too large in individual amounts, to be met in full by existing local banking and financial institutions." I would have added that those existing institutions need to be changed in a number of ways which would enable them to make a greater contribution toward financing those capital needs.

One source of the requisite analyses and reform ideas in recent years has in fact been the Federal Reserve System. A number of reports by officials, committees, and staff members have dealt with the desirability of changes in rural banking structure, correspondent credit arrangements, usury laws, access to money markets, and, in particular, with increasing the amount of Federal Reserve discount credit that is readily available to rural banks. Several members of the academic community have also contributed to this public discussion.

Drawing in part on these various observations, the President's 1971 Report on Financial Assistance to Rural Areas went beyond the usual exhortations to list several changes that would reduce impediments in the ability of rural banks to finance agriculture:

--greater use of correspondent banks and increased participation in loans with non-bank lenders;

--greater use of branch banking and formation of more holding companies;

--creation of new institutions or instruments to provide greater access to money markets;

--liberalization of Federal Reserve discounting restrictions, as applied to rural banks.

These points cover several impediments to rural bank financing and in the balance of my remarks I will be examining these and other suggestions for improving the level of bank lending to agricultural and rural communities.

A factual base is needed from which one might estimate the credit dimensions of potential improvements in banking practices and structure. This is provided in the accompanying tables containing pertinent available facts about rural bank lending.

The data are taken from the June 30, 1971 Reports of Condition which all banks file with their primary supervisors. As of that date, agricultural loans by all insured commercial banks amounted to $16,149 million. Since the focus of our attention is on banks in rural areas, the tabulation is restricted to banks outside of SMSA's. This exclusion eliminates lenders in large cities but the remaining banks account for $11,247 million in farm mortgages and loans to farmers. The sample, therefore, covers over two-thirds of total farm loans. The data are detailed by State, by size of bank, and by whether or not the bank is a member of the Federal Reserve System. Not all States are shown in the tables but the 21 States included make up 85 per cent of the total of farm loans held by banks outside of SMSA's.

At such banks in these 21 States, loan-to-deposit ratios range from 49 to 64 per cent and average 57 per cent (Table II). Levels of lending are considerably higher than they were a decade ago but still fall short of those prevailing in city banks. There seems to be no consistent difference in lending by members and nonmembers when similar sized banks are compared, either as to the level of total loans or the shares lent to farmers (Table I).

To me the most interesting, and in some respects the most significant, facts have to do with size and character of cash assets of rural banks (Tables II and III). Cash assets are currency and coin, cash items in the process of collection, demand deposit balances with banks, and, in the case of Federal Reserve member banks, reserve balances with the Federal Reserve Bank. Among the 21 States, for member banks, cash assets range from 10.2 to 16.9 per cent of deposits; for nonmembers, from 6.4 to 15.9 per cent. Nonmembers average about 3 percentage points less than members, due mainly to the differences in reserve requirements. Using these data, what can one say about the significance of proposals to modify banking practices?

<u>Correspondent banking</u>. Small banks obtain many services from other and usually larger banks. Traditionally the smaller bank has paid for these services indirectly, by maintaining a demand deposit account at larger banks. A portion of rural banking resources is therefore at all times tied up in balances at city banks, rather than being available for loans. The sums involved are significant, ranging, among the 21 States, from 4.7 to 13.4 per cent of total deposits in the case of nonmembers to 3.3 to 8.7 per cent in the case of members (Table III). Within a given state, this ratio tends to be higher at the smaller banks (Table IV).

Can banks free up funds for achieving higher loan levels by reducing correspondent balances? This simple suggestion is in line with a steadily growing line of thought in many progressive banks, on using fees rather than balances as a method of compensation.

Thus, where local credit conditions warrant, rural banks would not place funds with city banks who would put them to work earning the money that pays for the services received. Instead, rural banks would put that part of these funds not needed for clearing purposes to work themselves, in local loans and investments. The local earnings would be used to pay for correspondent services on a fee basis.

Why has this change not been made--why the continued siphoning off of rural banking resources? Mainly, I believe, because paying for banking services through deposit balances has been a standard industry practice for such a very long time. Generally, banks compensate each other in this fashion and they use the same practice for other bank customers, whether corporations, individuals or governments. So far as correspondent banking involving rural banks is concerned, the practice goes back to an era when rural banks quite properly assigned a low opportunity cost to a significant share of their deposits; in general, they had more loanable funds than loan demand and it was convenient and equivalent to laying up "treasure in heaven" to have a valued deposit relationship with a city correspondent. For many rural banks, this era ended from 5 to 10 years ago. Some banks have responded by trimming their balances, but what is needed is a basic shift toward fees as a method of compensation for correspondent services.

The city correspondents, on their part, have generally preferred to be paid through deposit balances mainly, no doubt, because that is is the way it has always been done. There is also a rather pervasive belief, not necessarily borne out by a cost analysis, that the system results, on the average, in higher prices for services rendered. Account analyses will answer the question of who gains or loses from compensating balance arrangements, but the point at issue has to do with bank customers. The rural bank's loan customers are clearly losers if the city bank's customers get access to the credit that they might have otherwise had access to. Now that rural bankers in many sections of the country are serving credit-short areas they should be seeking city correspondents who are prepared to sell their services on a fee basis, thus allowing the rural bank to keep more of its funds at work in its own community.

Among the correspondent services available are participations in rural lending by city banks. For some rural banks these arrangements are very important. Obviously they can offset, or even more than offset, the drain of funds to city banks. Our data-reporting system does not regularly provide information on such fund flows. We do know that participations run upstream as well as downstream and there is evidence that in some States on a net basis the flow is defying gravity. We also know that country banks sell Federal funds and buy certificates of deposit in correspondent banks--the amounts are now about 4 per cent of total deposits; there is very little reverse flow in Federal funds or certificates.

Banking structure. Another significant inefficiency in the utilization of rural banking resources is manifested in the previously noted lower loan-deposit ratios at which small rural banks generally operate, as compared with larger unit banks or branching systems.

Admittedly these ratios could be higher but there are hazards involved in reaching for the levels of loan saturation feasible for large and diversified lenders.

A rural unit bank typically serves a small market area with relatively undiversified economic activity. Because many of its borrowers are engaged in the same enterprise or in related activities, their economic fortunes are likely to rise and fall in concert. In this usual rural environment, the overall lending risk faced by the bank is necessarily greater than if it had a more diversified loan market, and under these circumstances and without special liquidity backup it is no less than prudent to maintain a higher percentage of secondary reserves.

In largely rural States, only statewide branching systems or holding companies can generally achieve the degree of diversification necessary to a significant improvement in the relative utilization of banking resources. States that continue to restrict or outlaw these forms of banking organization may be imposing an unnecessary limitation upon loan accommodations to their rural residents. For instance, correspondent demand balances appear to absorb a smaller percentage of rural bank assets in States where holding companies are active, as in the Ninth District (Table III).

Also, it is only through statewide branching, or indirectly through active group banking, that rural borrowers can hope to enjoy the advantages of being served by larger banks in a position to realize economies of scale. Very small banks, with under $5 million or so in deposits, have significantly higher unit costs which must in some way be borne by their customers in the form of less service, higher loan rates or lower time deposit earnings. In addition, small banks are often unable, legally or prudently, to meet the loan demands of the larger firms in their communities. These may, of course, be met by recourse to correspondent participations. I have already noted the problems entailed in paying for correspondent services.

Finally, the larger banks have better access to loanable funds in the nation's capital and money markets, which is an advantage few, if any, small banks have been able to match at present.

On the other side there is a deep-seated conviction on the part of many informed persons that branching and holding company systems result in a draining away of rural savings for urban or other remote investment. In theory, a statewide system will reallocate resources on the basis of comparative need and effective demand. If rural and agricultural demands are less urgent and less able to compete on a market basis the funds should go elsewhere. Whether the larger systems tend to show a preference for non-agricultural customers has not been established one way or another so far as I am aware. The very nature of the banking business argues to the contrary. Banks have two masters--depositors and borrowers. If one has priority in these times it is the depositor and his community. It is doubtful to me that any bank would disregard or risk the allegation it was disregarding the needs of the community which supports its deposit position and growth.

Access to capital markets. The nation's larger banks have been meeting a growing portion of their loan demand in recent years by raising funds in national and international money markets. Within broad limits during normal monetary conditions, these banks are able to gear such fund-raising activities to their loan demand, so that their ability to make loans is freed from sole dependence on growth in regular demand and savings deposits. The nature of these markets is such, however, that small and even medium-sized banks can make only limited use of them; in consequence their lending ability still depends primarily on growth in local deposits. Thus, regions and sectors that tend to be served by smaller banks--such as rural areas and agriculture--are handicapped in their access to credit.

I have already mentioned changes in banking structure that would help remedy this condition. In addition, it is possible to set up arrangements through which access of the smaller banks to money markets can be achieved. One promising technique is to raise funds by the sale of existing portfolios of agricultural loans into pools which are financed by the sale of participations in national money markets.

Rural bankers are becoming more aware of the possibilities and are taking the initial steps along this line. A committee of The American Bankers Association's Agricultural Credit Task Force, reporting at last fall's ABA Agricultural Credit Conference, recommended "that consideration be given to establishing a regional or national mechanism to provide ready marketability for agricultural production credit paper and other credit closely related to agriculture." The committee suggested that this be accomplished through an organization of banks, operating either on their own or with governmental backing. The agricultural credit corporation thus created would discount some loans for its member banks, participate in others, and even purchase some high quality paper without recourse. It would establish a reserve fund against losses, financed by percentage fees from banks utilizing the corporation. To secure funds for these activities, the credit corporation would sell negotiable debt instruments in the money market. By way of an analogy, it is clear that in the important respects, this ABA committee of rural bankers wants to create an organization that would provide rural banks with credit services similar to those provided to production credit associations by the Federal Intermediate Credit Banks.

Another Task Force committee reporting at the same ABA meeting similarly recommended "permissive legislation for banks to go together in forming an Agricultural Credit Corporation." But in addition to using such an organization to tap money markets, this committee also emphasized that the corporation could be used as the vehicle through which those rural banks with surplus funds could purchase instruments from other rural banks at which loan demands were pressing hard against resources.

To these pool proposals by the ABA committees, I would add the following suggestions for securing improved access to money markets:

(1) the possibility of obtaining private insurance for some agricultural and other loans, thereby making them more salable to private investors. In fact, under the Holding Company Statute one large bank has applied for and received authority to create a subsidiary to insure loans of a similar type--in this case small businesses.

(2) the possibility that the large money market banks can endorse and/or market, for a reasonable fee, acceptances originated by smaller banks. Some of the larger banks serving rural areas are already marketing their own acceptances (mostly representing credit secured by cattle in feedlots) through dealers in New York, and this proposal would extend this avenue to still smaller banks.

Federal Reserve discount credit. The final institutional changes to be mentioned relate to the Federal Reserve discount mechanism. This is the procedure through which Federal Reserve member banks can borrow funds for short periods of time from their Federal Reserve Bank. Some time ago, the Federal Reserve System, considering the altered financial environment in which banks were operating today, began an intensive review and analysis of the functioning and role of its discount facility.

The Committee that undertook this task made a thorough and lengthy investigation of all aspects of the problem and in

July, 1968, presented its report and supporting evidence to the Board of Governors. Two of the principal recommendation in that Report would, I believe, significantly improve the ability of rural banks to serve their communities. I want to discuss them briefly.

Over the postwar years, a majority of rural member banks had not used the discount window at all, and others only infrequently. Many rural bankers got the impression that discounting was a "forbidden fruit." This impression was fostered because the Federal Reserve did not clearly define the difference between appropriate and inappropriate use of Reserve credit. To remedy this situation, the Committee recommended that basic borrowing privilege be established for each member bank. Under it a bank could, with no questions asked, borrow up to specified amount for specified number of weeks in each year. Thus the extent to which Federal Reserve borrowing could be used as a ready source of short-term adjustment credit would be known. It was anticipated that many more bankers would rely on this source of funds and thereby enhance their ability to serve their local communities.

The study Committee also concluded that borrowing by rural banks to meet seasonal deposit outflows and loan extensions associated with agricultural production was appropriate and should be encouraged. Thus, a second major recommendation was that a seasonal borrowing privilege be instituted. The specific proposal recommended was of great significance to those banks exposed to large seasonal variations relative to the size of the bank. Under the seasonal borrowing privilege as outlined, banks could arrange for Federal Reserve funds to accommodate all of their seasonal outflow exceeding a certain percentage--perhaps 5 to 10 per cent--of their average level of deposits. Such generous seasonal access to Federal Reserve credit, we believed, was justified by the demonstrated inability of small rural banks to obtain seasonal funds in money markets. Given the assured seasonal access to Federal Reserve credit, these banks could begin to make longer term loans for both farm and nonfarm purposes, using some of the funds that presently must be kept in liquid instruments in order to be available for the seasonal demands.

Since that Report was completed and made available for general discussion and examination, I believe that a very large measure of public and industry support for the recommendations has become evident. In fact, many of the more technical specific proposals have been put into practice and I believe that attitudes toward discounting within and without the System have moved significantly toward the philosophy of the original recommendation.

One troublesome problem--how to define the limits to seasonal accommodation--has been under continuing study and I believe we now have a more workable system than we had two years ago.

It is not surprising that I, as the Chairman of the original study Committee, regret that the Federal Reserve has not yet fully implemented the Committee's recommendations. One difficulty has been that liberalized access to the discount window should be introduced during a time of relative neutrality in monetary policy, and such times have been scarce and brief since 1968. As I indicated, our staff has been continuously working to refine the proposals, especially the rules and administration of the seasonal privilege.

The Federal Reserve is a conservative institution which usually moves deliberately after full study and consideration. But I do not think it would be fair to say we would deliberately study a problem until it became extinct, and for that reason I can hope we will soon be doing our bit to improve the ability of the private sector to finance rural economies and agriculture. I challenge those of you concerned to do likewise.

Table I. Loans to Farmers, by Member and Nonmember Banks

Insured Commercial Banks Outside of SMSA's in 21 Agricultural States
June 30, 1971

| State* | Farm Loans (millions of dollars) | | | Farm Loans as Percentage of Total Loans — Deposit Size of Bank (millions of dollars) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | 5 or Less | | 5-10 | | 10-25 | | 25-50 | | Over 50 | |
| | Total | Member Banks | Nonmember Banks | M | N | M | N | M | N | M | N | M | N |
| Iowa | 1,139 | 318 | 821 | 66 | 63 | 58 | 55 | 39 | 41 | 21 | 24 | 19 | -- |
| Texas | 747 | 434 | 313 | 45 | 34 | 34 | 33 | 26 | 26 | 11 | 14 | 19 | -- |
| Nebraska | 745 | 380 | 365 | 78 | 70 | 67 | 61 | 54 | 54 | 33 | -- | -- | -- |
| Kansas | 740 | 371 | 369 | 63 | 62 | 58 | 47 | 37 | 32 | 20 | 12 | 16 | -- |
| Illinois | 713 | 380 | 333 | 45 | 43 | 35 | 37 | 27 | 28 | 17 | 11 | 6 | -- |
| Minnesota | 676 | 224 | 452 | 46 | 51 | 32 | 42 | 20 | 25 | 11 | -- | -- | -- |
| Missouri | 545 | 153 | 392 | 44 | 47 | 36 | 39 | 28 | 31 | 16 | 18 | 2 | 4 |
| Wisconsin | 460 | 128 | 332 | 26 | 36 | 22 | 31 | 17 | 21 | 6 | 10 | 4 | -- |
| Indiana | 398 | 173 | 225 | 35 | 35 | 27 | 29 | 22 | 25 | 9 | 20 | 5 | 8 |
| Oklahoma | 380 | 237 | 143 | 49 | 48 | 40 | 39 | 33 | 37 | 12 | 8 | 1 | -- |
| South Dakota | 358 | 194 | 164 | 70 | 73 | 65 | 71 | 45 | 46 | 43 | 40 | 28 | -- |
| Kentucky | 345 | 121 | 224 | 50 | 39 | 33 | 33 | 24 | 17 | 12 | 6 | 12 | 5 |
| Ohio | 316 | 218 | 98 | 33 | 28 | 24 | 27 | 14 | 13 | 7 | 6 | 5 | 6 |
| North Dakota | 300 | 102 | 198 | 62 | 64 | 46 | 55 | 32 | 39 | 15 | 32 | -- | 36 |
| Georgia | 298 | 46 | 252 | 19 | 26 | 18 | 28 | 13 | 15 | 5 | 4 | -- | 5 |
| Arkansas | 280 | 104 | 176 | 22 | 35 | 31 | 37 | 24 | 29 | 14 | 18 | 2 | -- |
| Tennessee | 255 | 70 | 185 | 17 | 32 | 20 | 24 | 11 | 19 | 9 | 11 | ** | -- |
| Colorado | 243 | 190 | 53 | 44 | 30 | 45 | 31 | 39 | 18 | 26 | 31 | 22 | -- |
| Mississippi | 241 | 48 | 193 | 24 | 34 | 18 | 35 | 15 | 24 | 7 | 14 | 9 | 14 |
| Montana | 222 | 158 | 64 | 53 | 25 | 40 | 42 | 38 | 45 | 13 | -- | -- | -- |
| Michigan | 203 | 102 | 101 | 20 | 22 | 16 | 16 | 8 | 13 | 8 | 11 | 4 | 5 |
| 21 States | 9,604 | 4,151 | 5,453 | | | | | | | | | | |
| All States | 11,247 | | | | | | | | | | | | |

* States are ranked in order by the amount of farm loans at banks outside of Standard Metropolitan Statistical Areas (SMSA's). Data are shown for the 21 states in which farm loans at such banks totaled over $200 million. Farm loans shown are real estate mortgage loans secured by farm land plus other loans to farmers.

** Less than 0.5 per cent.

M=Member banks.

N=Nonmember banks.

Table II. Deposits, Loans, and Cash Assets

Insured Commercial Banks Outside of SMSA's in 21 Agricultural States*
June 30, 1971

| State and Class of Banks | Total Deposits (millions of dollars) | | Selected Assets as Percentage of Total Deposits | | | |
|---|---|---|---|---|---|---|
| | All Banks | Banks Outside SMSA's | Total Loans | Loans to Farmers | Cash and Demand Balances | Federal Funds Sold and Other Balances |
| Iowa | 6,830 | | | | | |
| Member | | 1,485 | 58 | 21 | 13 | 3 |
| Nonmember | | 2,797 | 59 | 29 | 9 | 2 |
| Texas | 26,813 | | | | | |
| Member | | 3,301 | 50 | 13 | 17 | 5 |
| Nonmember | | 1,890 | 57 | 17 | 16 | 3 |
| Nebraska | 3,615 | | | | | |
| Member | | 1,176 | 59 | 32 | 13 | 2 |
| Nonmember | | 904 | 63 | 40 | 9 | 3 |
| Kansas | 5,151 | | | | | |
| Member | | 1,624 | 54 | 23 | 15 | 4 |
| Nonmember | | 1,435 | 53 | 26 | 11 | 5 |
| Illinois | 36,723 | | | | | |
| Member | | 3,143 | 48 | 12 | 12 | 4 |
| Nonmember | | 2,063 | 50 | 16 | 9 | 3 |
| Minnesota | 9,409 | | | | | |
| Member | | 1,748 | 58 | 13 | 11 | 2 |
| Nonmember | | 1,938 | 57 | 23 | 7 | 1 |
| Missouri | 11,471 | | | | | |
| Member | | 1,035 | 53 | 15 | 14 | 4 |
| Nonmember | | 2,045 | 52 | 19 | 10 | 4 |
| Wisconsin | 10,025 | | | | | |
| Member | | 1,864 | 61 | 7 | 11 | 3 |
| Nonmember | | 2,258 | 56 | 15 | 8 | 2 |

Continued next page.

Table II. Deposits, Loans,

| State and Class of Banks | Total Deposits (millions of dollars) All Banks | Total Deposits (millions of dollars) Banks Outside SMSA's |
|---|---|---|
| Indiana | 10,968 | |
| Member | | 2,219 |
| Nonmember | | 1,826 |
| Oklahoma | 5,806 | |
| Member | | 1,675 |
| Nonmember | | 746 |
| South Dakota | 1,616 | |
| Member | | 700 |
| Nonmember | | 454 |
| Kentucky | 5,521 | |
| Member | | 1,060 |
| Nonmember | | 1,719 |
| Ohio | 22,010 | |
| Member | | 3,125 |
| Nonmember | | 1,076 |
| North Dakota | 1,434 | |
| Member | | 599 |
| Nonmember | | 750 |
| Georgia | 7,507 | |
| Member | | 776 |
| Nonmember | | 1,880 |
| Arkansas | 3,200 | |
| Member | | 1,040 |
| Nonmember | | 993 |
| Tennessee | 7,777 | |
| Member | | 1,246 |
| Nonmember | | 1,553 |

Continued next page.

and Cash Assets (continued)

| Selected Assets as Percentage of Total Deposits | | | |
|---|---|---|---|
| Total Loans | Loans to Farmers | Cash and Demand Balances | Federal Funds Sold and Other Balances |
| 54 | 8 | 12 | 5 |
| 54 | 12 | 8 | 5 |
| 49 | 14 | 16 | 8 |
| 52 | 19 | 14 | 8 |
| 63 | 28 | 11 | 1 |
| 56 | 36 | 10 | ** |
| 54 | 11 | 15 | 4 |
| 52 | 13 | 12 | 4 |
| 59 | 7 | 10 | 3 |
| 59 | 9 | 8 | 3 |
| 60 | 17 | 11 | 1 |
| 53 | 26 | 6 | ** |
| 64 | 6 | 14 | 3 |
| 63 | 13 | 10 | 4 |
| 51 | 10 | 15 | 3 |
| 56 | 18 | 14 | 2 |
| 55 | 6 | 13 | 4 |
| 57 | 12 | 11 | 3 |

Table II. Deposits, Loans, and Cash Assets (continued)

| State and Class of Banks | Total Deposits (millions of dollars) | | Selected Assets as Percentage of Total Deposits | | | |
|---|---|---|---|---|---|---|
| | All Banks | Banks Outside SMSA's | Total Loans | Loans to Farmers | Cash and Demand Balances | Federal Funds Sold and Other Balances |
| Colorado | 4,580 | | | | | |
| Member | | 835 | 64 | 23 | 16 | 2 |
| Nonmember | | 283 | 64 | 18 | 14 | 2 |
| Mississippi | 3,282 | | | | | |
| Member | | 806 | 53 | 6 | 16 | 3 |
| Nonmember | | 1,418 | 54 | 14 | 11 | 5 |
| Montana | 1,656 | | | | | |
| Member | | 918 | 60 | 17 | 13 | 2 |
| Nonmember | | 268 | 60 | 24 | 8 | 1 |
| Michigan | 21,932 | | | | | |
| Member | | 2,019 | 62 | 5 | 10 | 4 |
| Nonmember | | 1,337 | 62 | 8 | 7 | 4 |

* Except data in first column, which shows total deposits at all insured commercial banks.
** Less than 0.5 per cent.
See notes to Table I.

Table III. Cash Assets as Percentage of Total Deposits

Insured Commercial Banks Outside of SMSA's in 21 Agricultural States
June 30, 1971

| | Member Banks | | | | | Nonmember Banks | | | |
|---|---|---|---|---|---|---|---|---|---|
| State | Total Cash Assets | Cash Items in Process of Collection | Currency and Coin | Demand Balances With Other Banks | Reserves With Federal Reserve Banks | Total Cash Assets | Cash Items in Process of Collection | Currency and Coin | Demand Balances With Other Banks |
| Iowa | 12.9 | 1.4 | 1.3 | 5.6 | 4.6 | 9.3 | .4 | 1.2 | 7.7 |
| Texas | 16.9 | .8 | 1.8 | 8.7 | 5.6 | 15.9 | .7 | 1.8 | 13.4 |
| Nebraska | 13.0 | 1.0 | 1.0 | 5.0 | 6.0 | 9.2 | .3 | 1.0 | 7.9 |
| Kansas | 14.7 | 1.5 | 1.2 | 6.7 | 5.3 | 10.7 | .4 | 1.1 | 9.2 |
| Illinois | 12.3 | 1.1 | 1.4 | 4.5 | 5.3 | 9.3 | .4 | 1.3 | 7.6 |
| Minnesota | 11.3 | 1.6 | 1.1 | 3.7 | 4.9 | 7.3 | .3 | 1.1 | 5.9 |
| Missouri | 14.3 | 1.5 | 1.6 | 5.6 | 5.6 | 10.5 | .3 | 1.6 | 8.6 |
| Wisconsin | 10.8 | 1.6 | 1.7 | 3.4 | 4.1 | 8.0 | .2 | 1.5 | 6.3 |
| Indiana | 12.2 | 1.5 | 2.0 | 4.5 | 4.2 | 7.8 | .6 | 1.6 | 5.6 |
| Oklahoma | 16.4 | 1.0 | 1.7 | 8.5 | 5.2 | 13.7 | .5 | 1.8 | 11.4 |
| South Dakota | 11.3 | .8 | 1.0 | 4.1 | 5.4 | 10.0 | .3 | 1.0 | 8.7 |
| Kentucky | 15.0 | .4 | 2.4 | 6.9 | 5.3 | 12.4 | .4 | 2.0 | 10.0 |
| Ohio | 10.5 | .8 | 2.2 | 3.8 | 3.7 | 8.2 | .4 | 2.1 | 5.7 |
| North Dakota | 10.7 | 1.8 | 1.1 | 3.6 | 4.2 | 6.4 | .7 | .8 | 4.9 |
| Georgia | 14.0 | 1.2 | 2.3 | 5.1 | 5.4 | 10.4 | .5 | 2.4 | 7.5 |
| Arkansas | 15.2 | 1.6 | 1.8 | 6.5 | 5.3 | 14.0 | .6 | 1.9 | 11.5 |
| Tennessee | 13.4 | .7 | 2.6 | 6.1 | 4.0 | 10.7 | .4 | 2.0 | 8.3 |
| Colorado | 16.3 | 1.5 | 1.5 | 8.0 | 5.3 | 13.5 | .6 | 1.6 | 11.3 |
| Mississippi | 15.7 | 1.2 | 2.7 | 7.5 | 4.3 | 11.3 | .5 | 2.2 | 8.6 |
| Montana | 13.2 | 3.9 | 1.2 | 3.3 | 4.8 | 7.7 | .5 | 1.4 | 5.8 |
| Michigan | 10.2 | .9 | 2.2 | 3.5 | 3.6 | 6.9 | .3 | 1.9 | 4.7 |

See notes to Table I.

Table IV. Demand Balances at Other Banks as Percentage of Total Deposits, by Member and Nonmember Banks and by Deposit Size of Bank

Insured Commercial Banks Outside of SMSA's in 21 Agricultural States
June 30, 1971

| | Member Banks | | | | | Nonmember Banks | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Total Deposits of Bank (millions of dollars) | | | | | Total Deposits of Bank (millions of dollars) | | | | |
| State | 5 or Less | 5-10 | 10-25 | 25-50 | Over 50 | 5 or Less | 5-10 | 10-25 | 25-50 | Over 50 |
| Iowa | 7 | 6 | 6 | 5 | 2 | 9 | 8 | 7 | 7 | -- |
| Texas | 12 | 9 | 8 | 10 | 6 | 16 | 13 | 12 | 13 | -- |
| Nebraska | 7 | 5 | 5 | 5 | -- | 9 | 7 | 7 | -- | -- |
| Kansas | 7 | 7 | 7 | 7 | 4 | 10 | 10 | 7 | 9 | -- |
| Illinois | 7 | 5 | 4 | 4 | 3 | 8 | 8 | 7 | 7 | -- |
| Minnesota | 5 | 5 | 3 | 3 | -- | 7 | 6 | 5 | -- | -- |
| Missouri | 7 | 6 | 5 | 6 | 3 | 10 | 8 | 8 | 9 | 9 |
| Wisconsin | 5 | 4 | 4 | 3 | 3 | 8 | 6 | 6 | 7 | -- |
| Indiana | 5 | 5 | 4 | 4 | 5 | 7 | 7 | 6 | 5 | 5 |
| Oklahoma | 11 | 9 | 7 | 9 | 9 | 14 | 10 | 10 | 9 | -- |
| South Dakota | 4 | 4 | 6 | 4 | 4 | 9 | 8 | 8 | 13 | -- |
| Kentucky | 4 | 8 | 7 | 6 | 10 | 9 | 9 | 8 | 5 | 27 |
| Ohio | 5 | 4 | 3 | 4 | 5 | 8 | 6 | 6 | 5 | 4 |
| North Dakota | 4 | 3 | 3 | 5 | -- | 6 | 6 | 4 | 3 | 4 |
| Georgia | 7 | 4 | 4 | 6 | -- | 9 | 7 | 7 | 6 | 5 |
| Arkansas | 15 | 6 | 6 | 6 | 6 | 12 | 12 | 11 | 12 | -- |
| Tennessee | 8 | 7 | 6 | 6 | 8 | 9 | 8 | 9 | 8 | -- |
| Colorado | 8 | 7 | 8 | 8 | 12 | 13 | 12 | 9 | 4 | -- |
| Mississippi | 6 | 8 | 8 | 8 | 7 | 12 | 9 | 8 | 10 | 6 |
| Montana | 5 | 4 | 3 | 3 | -- | 6 | 6 | 6 | -- | -- |
| Michigan | 5 | 4 | 3 | 4 | 3 | 6 | 6 | 5 | 4 | 2 |

See notes to Table I.