

Washington, D. C., April 16, 1915.

Dear Mr. Clemens:

I have received a letter from Mr. L. C. Irvine suggesting that I give you an outline of a plan for a system of rural credits in Alabama that was discussed at a meeting of the Alabama Land Congress at Mobile, in the fall of 1912.

I wish to say that the subject of rural credits is one that does not properly come within the purview of the Federal Reserve Board, and at the last session of Congress a joint committee was appointed, as you know, to consider the subject and report to Congress at its regular session next winter. What I have to say, therefore, must not be regarded as an expression of the views of the members of the Board, or as having any official significance whatever, as I am writing purely as a citizen of Alabama who feels a deep interest in the development of our State along all legitimate lines.

The events of the past six months have demonstrated in a forcible way the necessity for crop diversification, and have shown the great advantages that would be gained by the division of large plantations into smaller farms actually owned by those cultivating them, thus correcting the evils of absentee landlordism. Our State enjoys great natural advantages as to soil and climate, and should attract thousands of desirable settlers from abroad and from other states. It is important also in order to secure the best results, that farm life be made more attractive. The chief obstacle in the way of the proper development of our rural communities in Alabama has been the lack of money at reasonable rates, and this circumstance has been one of the principal factors in making us so dependent upon a single crop. Our present credit system practically forces the production of cotton to the virtual exclusion of all other money crops, and year after year we have seen a large part of the money which comes into the State for the purchase of cotton go out again to pay for foodstuffs, including both grain and meat. Some headway has been made in recent years in the production of corn, and in a few localities the live stock industry has shown signs of promise. Vast tracts of land, however, are planted in cotton every year or are permitted to lie fallow, that are admirably adapted for cereals, for potatoes, for sheep grazing or for cattle raising. Even in the production of cotton our methods are in most cases crude, and as a rule our farmers are not able to adopt the advanced systems that obtain in other sections of the country, which are less favored by nature.

I am sure that there are many tenants who would be glad of an opportunity to become landlords, and that there are many small landlords who would like to diversify and to adopt more scientific methods of farming, if they could make the necessary financial arrangements; but going into debt is a serious thing, and the idea of a loan of a few hundred or a few thousand dollars for two or three years at a high rate of interest secured by a mortgage upon the farm, which is at the same time a homestead, is not attractive. It would mean in many cases the shifting of

the loan at maturity, or a foreclosure; but if loans to run 25 or 30 years could be had, repayable in annual installments which would be less than ordinary interest payments under present conditions, the whole aspect of the case would be changed.

The Federal Reserve Act, which has revolutionized the financial system of the country, does not provide, as far as the public is concerned, any new banks of deposit or discount. It merely created a coordinated system of banking, and established for the use and protection of banks already in existence, twelve additional banks.

The interest in rural credits, while widespread, is not as great in some sections as in others, nor is the need for such a system in some of the older and wealthier states, as great as is the case in the south. It seems to me that the question is essentially one for consideration by the states, and that if there were land banks established in several states, that a basis would thus be afforded the National Government for its cooperation.

The legislature of Alabama will convene again in July to consider a plan for the permanent relief of the State treasury as proposed by Governor Henderson, which will, if adopted by the legislature, call for the submission to the people of an amendment to the Constitution. The rural credit plan discussed at the Alabama Land Congress would also require, to become effective, an amendment to the Constitution.

It seems to me, therefore, that the time is opportune for the serious consideration of some adequate plan for the safe and proper development of our farming districts. It is not proposed that the State should engage in the banking business; that experiment was tried 90 years ago and resulted 15 years later in disaster. Nor is it suggested that our laws be changed so as to encourage wild speculation in lands, or to permit the operation of irresponsible or mushroom organizations. The banks of Alabama have done a great deal for the development of the State, and many of them make loans on real estate. These banks all use for this purpose funds on deposit with them on which in most cases interest is paid. Their terms, therefore, are necessarily not as liberal, both as regards the duration of the loan and the rate of interest, as are desirable, and if every farm mortgage loan now carried by Alabama banks should be repaid, there should be no difficulty in employing these funds to good advantage in building up the commercial interests of the State. I hope, therefore, that after the plan proposed is carefully studied, and if it should be found to be sound and practicable, that it will not be opposed by the banking interests of the State. It is thought that its adoption would relieve them of fixed loans, that it would at the same time develop a broader field for desirable temporary loans, and would furthermore tend to increase deposits.

The plan suggested would call for the incorporation and organization of a land mortgage bank to be located in such city as may be determined by the legislature, with a paid in capital of say \$500,000, and with an authorized capital of five or six times that sum. As private lenders are exempt from taxation on mortgage loans after the record fee

of \$1.50 per thousand has been paid, it would be necessary in order to secure subscriptions to the capital stock, to exempt shares of stock in the land mortgage bank from taxation. It would be well to have the stock as widely scattered over the State as possible, and, therefore, a tentative allotment should be made to citizens of each county in proportion to its population. Should the citizens of any county fail to subscribe for the full amount allotted them, the balance could be taken by citizens of other counties.

The land mortgage bank should not be permitted to receive deposits of any kind, and its operations should be limited to the investment of its own capital and of the funds secured by a pledge of its mortgage loans. Large profits should not be permitted to be a consideration, all loans should be made at rates of interests as reasonable as possible, and the expenses of administration should be kept down as far as may be consistent with efficiency. It is suggested, therefore, that dividends to stockholders be limited to six per cent per annum, and that the balance of earnings, after carrying a small part to surplus, should be paid over to the State for the school fund, for the construction of good roads, or for such other purposes as may be determined by the legislature.

Great care should be taken in passing upon applications for loans, which should be limited to farms in cultivation upon a basis of not exceeding 50% of actual values, and reference should be had to the books of the county tax assessors in determining these values. So far as possible, applications should bear the approval of two or more stockholders of the land bank residing in the county where the property is located. Competent actuaries should be consulted in order that the annual payments, which should include the interest charge and the amortization payment, may be scientifically correct. It might be well to authorize the tax collectors in the various counties to collect these payments for the land bank at the time the taxes on the property are paid.

When the funds provided by the paid in capital stock shall have been exhausted, the land bank should be authorized to deposit its mortgages with a trustee to secure an issue of collateral trust bonds, the proceeds of which should be used for additional loans. The total issue of collateral trust bonds should not exceed four or five times the actual paid in capital, so that if the land mortgage bank should begin business with a capital paid in of \$500,000, its maximum limit of collateral trust bonds would be \$2,500,000. After that figure is reached, it would be necessary to increase the capital stock before making additional loans. A proper proportion of these bonds, represented by the amount of amortization payments, should be retired annually. In order to secure the best results, and to enable these collateral trust bonds to have the widest possible market and to command the lowest rate of interest, the State should guarantee payment of principal and interest. This suggestion I know is sure to meet with some opposition. It seems to me, however, that the interests of the State could be thoroughly safeguarded, and that its margin of security would be ample. In the first place, the loans would be well scattered; next, the State would have in its own hands the collection of the interest and amortization installment that would become due each fall; and third, it should have a share in the

management of the bank by providing that not more than two-thirds of the directors should be chosen by the stockholders, and that at least one-third should be appointed by the Governor to represent the State; or it might be provided that certain State officers, elected by the people, should be ex-officio directors of the land mortgage bank. Furthermore, should the total amount of collateral trust bonds to be issued, be limited to four or five times the paid in capital of the land mortgage bank, the State would always have a margin of at least 20 per cent for its protection, represented by the amount of the paid up capital.

The legislature of the State of South Carolina recently enacted a law providing for a system of state warehouses. Receipts for cotton stored in these state warehouses are supported by the faith and credit of the State, and I am informed, are readily accepted as collateral for loans, both within and without the State, at very low rates of interest. Perhaps it might be well to adopt a similar warehouse system in the State of Alabama, but this reference is made merely to show the effect of a state guaranty. I think there is no doubt that a bond, secured by well selected mortgages, bearing a low rate of interest and guaranteed by the State of Alabama, would be eagerly sought by investors. Probably the bulk of such an issue would be absorbed by local money savers.

I am of the opinion that should a system be worked out along the lines suggested above, that the land mortgage bank could afford to make farm loans, running approximately 25 years, at an annual rate, including the amortization, of not exceeding the straight legal rate of interest in Alabama. An encumbrance of this kind, besides providing means for crop diversification and for the improvement of farms, would really make more saleable the farm so mortgaged. For instance, suppose that a farmer who had carried his loan for five years desired to sell his place, - the purchaser would merely pay him his equity, and assume the remaining 20 annual payments. A system of this kind, properly operated, would greatly increase taxable values throughout the State, and should our legislature look with favor upon this idea, it only would be following in the footsteps of other states that have already contributed both of their resources and of their credit to the up-building of their agricultural communities.

The objection will probably be urged that this would be class legislation, but as a constitutional amendment would be necessary for it to become effective, the system could be adopted only by a majority vote of the people, which would demonstrate that the legislation is after all not for a class, but for the best interests of a majority of the people of Alabama. If not adopted, no harm would be done, as an election would have to be held in any event should the legislature adopt Governor Henderson's views regarding permanent measures for relieving the finances of the State.

I do not wish to be understood that a guarantee by the State of the collateral trust bonds to be issued by the proposed land mortgage bank is absolutely essential for the success of a rural credit system in Alabama. Exemption of the stock of such a bank, however, from all taxation whatever, is, from the reasons already cited, absolutely necessary. It

may be that State supervision and close cooperation between the State officials and stockholders of the land mortgage bank, and the good quality of the loans in which its capital stock would be invested, would be enough to inspire sufficient confidence in the bank's collateral trust bonds to make them marketable at a fair rate of interest, by no means as low, however, as would be the case if the bonds were supported by the credit of the State. I appreciate moreover, the dangers that would attach to the policy of making the State the guarantor of obligations indefinite as to amount, and am of the opinion that in case it should be decided to submit the ideas above advanced to the legislature, it might be well to limit the total issue of bonds to be guaranteed by the State to a fixed sum, say \$2,000,000, which would, on the basis of a paid in capital of \$500,000, give the State a margin of 25%. After this amount had been invested in farm mortgages, the system would have then been tested out and understood, and if proved a success, further bond issues could be floated on satisfactory terms without recourse to the credit of the State.

There are doubtless many legal matters which should be considered in this connection, which I as a layman am not qualified to discuss. The object of this letter is to sound the sentiment in Alabama as regards rural credits, and should the idea arouse any interest it might be well to submit the entire question to the consideration of the various commercial bodies in the State, in order that the details may be worked out, that the legal questions may be duly considered, and that a bill may be drawn by competent counsel.

Very truly yours,

W. P. G. Harding,

Mr. W. M. Clemens, Managing Editor,

The Mobile Item,

Mobile, Ala.