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AGRICULTURE AND THE COMMERCIAL BANKS

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For nearly forty years I have been talking to bankers in the United States about the growing credit needs of modern agriculture and the vital role that banks have in meeting those needs. My biases on this subject, if not already known to you, would become apparent soon enough; thus I might do well to confess them at the outset.

The trends in the modernization and reorganization of your agriculture appear to parallel those found in the United States. Basically, three things are happening.

First, the cash expenses required for each dollar's worth of farm production are increasing. Farmers are using more fertilizer, insecticides, petroleum, electricity, and similar items; the cash expenses have risen in proportion to the value of the output, and in Canada now stand at about half of the gross sales. Concurrently, this has given rise to the need for more short-term credit.

Second, machines and other capital equipment, as well as livestock, are becoming more important in production, and labor is becoming less important. Thus there is more need for intermediate-term credit to finance such investment.

Finally, on certain types of farms, such as the wheat farms that are so important in Canada, the increased volume of production that can be handled by an individual farmer is providing incentives to increase the physical size of individual farms. The enlargement and consolidation of farms has created an additional need for long-term credit over and above that normally required to finance the transfer of farms from one generation to the next.

All these credit needs, you will note, arise from a need to finance reorganization rather than aggregate expansion. While agricultural output continues to expand, it is primarily due to the phenomenal increase in productivity rather than in agricultural employment. As a matter of fact, agricultural employment in the States--and I understand in Canada--has been decreasing not only percentagewise but in actual numbers for several years, and from all indications the trend should continue for some years to come. This shift is basically the result of the substitution of capital for labor whether this be through mechanization, the increased use of purchased inputs that I mentioned, or investment in research that has led to better methods or materials or improved strains of plants and animals.

Viewing the decline in farm employment, it is easy to look on agriculture as a declining segment of our economy. Yet the fact is that agriculture is our one basic and indispensable industry, and its continued expansion of output must necessarily keep pace with population growth, both domestic and international. Furthermore, we should remember that it is only through increased productivity of agriculture that we have been able to release labor from the basic job of providing food and clothing and thus to supply the labor to man the other segments of our economy in furtherance of the higher standard of living and cultural attainment that we enjoy.

We should also remember, when we are inclined to think of agriculture as a sector of declining relative importance in our total economy, that much of the apparent decline results not from a loss but from a shift of locale from the farm to the city. For example, power is an essential element in farming. Nowadays, production of power on the farm in the form of horses and horse feed has been replaced by the production elsewhere of tractors, oil, and gasoline. Yet that does not make agricultural use of power any less an integral element in our economy. Nor does the fact that the processing of meat, milk, and fibre has moved from the smokehouse, the hand churn, and the spinning wheel to the packing plant, the milk plant, and the textile mill in the city mean that the role of agriculture in providing our food and clothing has diminished.

In other words, agriculture like the rest of our economy is becoming more and more specialized, yet each part is interdependent one with the other. In the aggregate, the whole complex which we sometimes refer to as "agribusiness" and which includes not only the farm production itself but also the provision of necessary equipment and supplies and the transportation, processing, and marketing of the product constitutes the major business of most countries.

For these reasons, continued progress in the reorganization of our farms and in the adoption of the technological advances that are making agriculture more efficient is of prime importance to the economic and social welfare of a modern nation. As such, it becomes of prime importance to the business community of that nation. Some businesses are affected more directly than others, but in the end all are affected by the cost and availability of food and clothing and--in your country as well as mine--by the contribution that agriculture can make to our balance of trade problem.

So the banker who says that he has little or no farm business, but who is intensely interested in the business of the agrichemical plant, the food processor, or the farm equipment dealer in his community, may be overlooking a bet. Unless he or someone takes an interest in the banking needs of the farmer in his area, there may be no business for some of his supposedly more valuable customers.

This brings me to the role of commercial banks in the financing of agriculture. There is no doubt but that the prosperity of each farm community depends in some measure on the ability of its farmers to secure the credit that permits them to adopt technological changes and to operate farms large enough to provide sufficient annual incomes. There is also no doubt but that the bank in that community has a self-interest in doing a good job of financing the farmers. Likewise, the bank in an urban industrial or trade center has a vested interest in the financing of the farm sector that supplies its community with the raw materials for its industries and with an important market for its products. In Canada, with your nationwide branch systems, you do not have rural and urban banks; instead, you have rural and urban branches of the same institutions.

In the United States the farm lending problems faced by commercial banks fall into several categories. First, there is the problem of the rural banks equipping themselves with people who can do an informed job of farm lending. Second, there is the problem of these banks obtaining the funds to lend: as the aggregate capital requirements of farming have tended to exceed the capital-generating ability of the farm community, the credit required by large individual farms has often exceeded the legal or self-imposed limits placed on the individual loans of country banks. Thus if adequate credit is to be provided through the banking system, larger urban banks must appreciate their own interest in solving the problem and must also equip themselves with personnel able to work knowledgeably in this field.

In Canada you do not have the problem of having to forge a link between city and country banks in order to move farm loan funds from one to the other. But the reports that I have seen appear to indicate that in many respects the other problems have been the same. Top management must come to appreciate the broad economic and social implications of the capital requirements of modern agriculture, and the operating personnel entrusted with the making of farm loans must be knowledgeable about modern agricultural practices. The latter is a very crucial point, and one at which problems arise in the United States and, I understand, also in Canada.

The common solution in the United States, in those banks in which the management is alert to the problem, is to employ a loan officer trained in agriculture and agricultural credit to specialize in servicing this sector. Graduates of agricultural colleges are frequently employed in this function, even though they may be lacking in credit experience, since it has been found easier to provide a well trained and experienced agricultural man with the necessary credit training than it is to provide a city credit man with the necessary agricultural background.

How can bank officers trained in agriculture serve their bank and the agricultural community? Our agricultural colleges have done a tremendous job of assisting farmers with their problems of production technology and the results are evident. Unfortunately we have not done as good a job on their financial problems. Traditionally, farmers have abhorred debt. This has frequently led them to avoid the use of credit that might well have been used to their advantage. They have also been notoriously poor bookkeepers. When the farm was largely a self-contained unit producing its own needs and merchandising its own output, cash flows were small and lack of records not too important. However, with the big increase in purchased inputs and size of operation and the corresponding increase in investment and operating capital requirements, records become essential in order to establish a sound basis for evaluation of credit needs.

There was a time when farm credit was based primarily on collateral without regard to repayment potential. With today's needs this is no longer adequate either for the borrower or the lender. It is here that banks with an adequate farm credit staff can assist farmers in helping them to set up and maintain appropriate records and in appraising their credit needs.

In an important sense, the bank that employs such persons can engage in the farm loan business with more assurance. For instance, it can begin to tell the difference between wise and unwise uses of credit among its farm loan requests, which is a rather basic capability for a bank to have. It can then in one set of circumstances confidently grant a loan that on the surface looks relatively large, but which will permit a proven farm operator to attain the size of enterprise that he needs to utilize fully his labor and management skills, as well as to obtain scale economies from fuller use of his equipment. But in the case of another apparently similar request, it might determine that the operator has visions beyond his management abilities, or perhaps that the expansion is being made at the wrong time, in the face of a falling market. It can, in short, make educated judgments on the merits of its farm loan requests, just as it expects to be able to appraise the loan requests of its nonfarm customers.

I might illustrate the value of agriculturally-trained personnel in banking in still another way. There are now, to my mind, three general classes of farm borrowers. The bank that is able to distinguish between them, and to adopt the appropriate attitude toward each, will be doing a much better job of serving its own interest, the interests of the farmer, and over the long run, as each individual case is multiplied thousands of times, the best interests of the economy and of the nation.

The first farm borrower is the one who might be labeled a growth firm if he were in a nonfarm business. He is the operator who has demonstrated that he is capable of managing a large modern farm. In this situation a seemingly bold financial program, one that permits the operator to attain the optimum size of enterprise for his current level of experience, may actually be the soundest, provided that it has been carefully considered. A lender who is excessively timid because of the lack of experience can delay the economic progress of such an individual.

But in the same situation, even a generally good farm manager will not always make the right decisions with respect to the use of credit. He may be swayed by an overzealous salesman, or may be either overestimating or underestimating his present management capabilities. So the bank needs not only to be able to identify the individual who has a good future in farming, but also to assess his immediate plans. The concept is certainly no different from that involved in making loans to other business, but the knowledge and insights that are needed are rather specialized.

The second type of farm borrower is the individual who has not shown the capacity to manage a modern farm of the size required to attain a satisfactory income. In this case, a knowledgeable lender can perform a real service by causing the applicant to take a hard look at his situation and what can be done about it. If the applicant is completely committed to agriculture as an occupation, perhaps he needs an unusual amount of advice and guidance in order to make a go of it. But if his career has not yet been hardened, perhaps he should be guided into an investigation of opportunities off the farm. The danger here is that the individual will gradually drift more heavily into debt, using up the equity that would at one time have served to finance his transfer into nonfarm employment. The bank, in this case, will rarely be in jeopardy of taking a loss on the loan; on the surface, in fact, these situations usually give the appearance on conservative lending. But the bank that "goes along" with such a borrower without stirring him to evaluate what might be done about his lack of financial progress is not performing an optimum farm credit function.

There is, however, a third situation in which lenders can properly provide credit that enables a farmer to live off his equity without breaking up his farm unit. This third type is the older farmer who has built an equity in his farm during his most productive years and who now wishes to remain on the farm during the remainder of his life. In these cases, it may be proper to expect that the debt will be paid through an eventual liquidation of the collateral; whereas with the younger man it would be a clear disservice to allow matters to proceed to this point.

Given the desirability of employing agriculturally-trained personnel, how can Canadian banks accomplish this when farm loans amount to just 9 per cent of total general loans? I think that part of this problem is in fact now in the process of being resolved simply through a growth in the aggregate dollar amount of farm loans. The present farm loan total of over $700 million, it seems to me, can justify the employment of many more specialists in farm lending than did the volume of $400 million in 1960, even though in both years the farm loans were about the same proportion of total loans. We need to distinguish, I believe, between the proportion of time that a top general officer of the bank can devote to farm lending, which might well have to be geared to the relative importance of the farm lending, and the possibility of profitably employing specialists in farm lending, which can instead be related to the total dollar volume of the farm credit.

I might also suggest that farm lending specialists might be profitably employed at a regional level. They could provide guidance for branch managers inexperienced in farm lending, and could be consulted by all on cases of large or unusual farm loans. They would also give continuity to the bank's farm lending program as branch managers come and go, and the positions would provide a natural avenue of advancement for farm lending specialists. Some banks in the United States have in fact developed farm service organizations that go far beyond a lending function. For example, a number have found that the skills of their agricultural staff in the field of farm management have attracted and enabled the bank to handle trust business that has more than offset the cost of the whole agricultural department.

There is another important aspect to this matter of the banks providing an improved service to the farm community. The bank ought to strive to be a comprehensive lender to its farm borrowers--in the parlance common in the United States--to be a "one-stop" source of credit. If a farmer scatters his credit around, getting some from a bank, some from a merchant, some from a feed dealer, and a little more from a credit union, he is doing himself a disservice and is unnecessarily increasing the risks to his creditors. Under such arrangements he is usually unable to secure as much credit in total as he could by dealing with a bank that has equipped itself to understand and service his credit needs properly. Repayment arrangements are unlikely to be planned with his flow of income in mind, maturity terms are likely to be shorter, and interest costs may well be higher. These persuasive arguments for securing a profitable farm loan business are available to the bank that has equipped itself to merit being entrusted by a farmer with the complete short- and intermediate-term credit needs of his farm and his family and even assistance on his long-term needs.

While I realize that banks are strictly limited in the extension of farm mortgage loans, many of our country banks in the States have found a profitable business in helping their farm customers find accommodation with insurance companies and other long-term lenders and then obtaining contracts with such lenders to service their loans. By handling his total credit needs, a bank has the opportunity to develop an account of sufficient size to justify the expense of assisting him in his record keeping. By the same token, it provides the bank with the necessary information regarding his operations and cash flows on which to base sound credit decisions.

In short, commercial banks can play a unique and important role in promoting the vitality of our commercial agriculture. To best perform this function, however, they must appreciate the nature of the task and prepare themselves to handle it. Success in so doing will make a significant contribution toward ensuring that our free citizens will continue to enjoy the fruits of abundant harvests.

Let me add one point in closing. Nature abhors a vacuum. If a need exists, sooner or later it will be filled. If the commercial banks of a community fail to find the way to meet the valid credit needs of the farmer on a basis that is profitable to both borrower and lender, they should not be surprised if government moves in to do the job. Believing as I do in private initiative and enterprise as bulwarks of our freedom, I would urge that commercial banks not lose this opportunity to render a public service to the community along with building a potentially profitable business for themselves.

This is no time for inertia or satisfaction with the status quo. In a dynamic economy, such as yours and ours, the challenge of today's ever-widening economic frontiers should be no less than that of the land frontiers of yesteryear which led our forebears to develop the land we enjoy today.