

BANK LENDING TO FARMERS IN THE SIXTH DISTRICT

Borrowing During 1950

Current Livestock Lending Policies

*Community Capital Accumulation
and Farm Financing*



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FEDERAL RESERVE BANK OF ATLANTA

Borrowing During 1950

Since the end of World War II, many farmers in the Sixth District have changed their way of farming rather rapidly. Outstanding among these changes are a greater dependence upon livestock and feed crops and less reliance on the traditional row crops. Some few farmers have completely substituted one type of farming for another. For example, a number of farmers whose cash sales formerly consisted entirely of cotton are now selling only fluid milk. Most of them, however, have merely added livestock and decreased their acreage of cash crops, but some have converted idle land or wasteland to improved pasture and added livestock with little or no decrease in cash crop acreages.

From a farm management standpoint, the increase in size of business is the most common characteristic of these changes. From a financial standpoint, the most common features are the increases in invested capital and in the amount needed for operating expenses.

The recent shift toward livestock has coincided with a period of favorable farm product prices and a large increase in farm income. Because of the marked improvement in their financial position, a large proportion of farmers can now meet the requirements for commercial credit. Country banks, therefore, have assumed a position of greater leadership in farm credit at a time when farmers' credit needs were undergoing the most far-reaching change of recent decades.

In order to meet farmers' credit needs more completely, country bankers have revised their lending policies and have participated in a wide variety of farm credit conferences, clinics, and schools. Some of them have established special farm credit departments with a full-time credit man in charge. It is well known that many banks have made great progress in enlarging and increasing their services to farm customers and in fostering a more efficient type of farming in their trade territories.

The purpose here is to report some of the results of a recent survey on bank lending to farmers. This survey was designed to yield some quantitative and qualitative information on bank lending with special emphasis on loans made for beginning or expanding

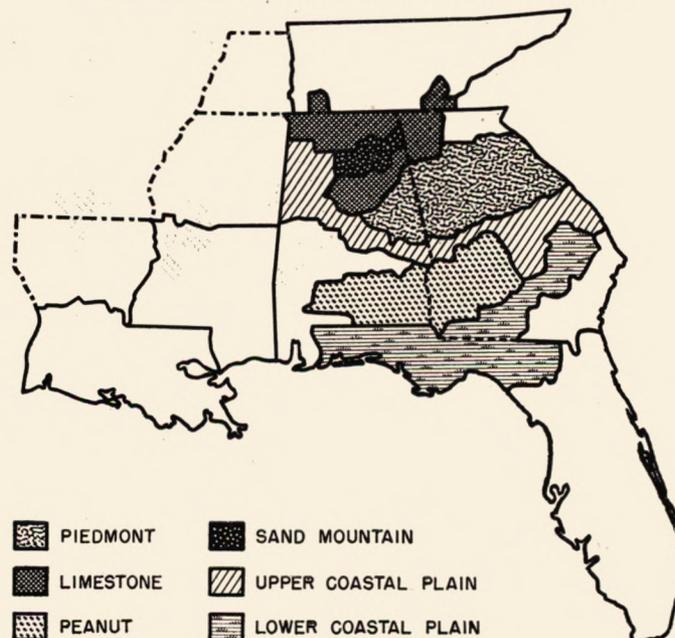
livestock programs or for other enterprises used to supplement or replace part of the income received from row crops. It is not, in any sense, a well-rounded summary of the contribution that country banks are making to the progress of agriculture. Although the extension of credit is one of the more important functions of country banks, it is only one of the services that banks render to farmers or to any of their other patrons.

How the Information Was Obtained

Information was obtained from 27 banks throughout the six farming areas shown here. Farmers in these areas, which were chosen because row crops are the main source of income, are now changing to systems that place more emphasis on livestock. The banks contacted ranged in size from about 700 thousand dollars to about 40 million dollars in total deposits. All the banks had either a larger-than-average volume of farm loans or a larger-than-average percentage of their total loans in farm loans.

At each bank the information was obtained by a personal interview with an officer who was thoroughly

FARMING AREAS INCLUDED IN FARM CREDIT SURVEY



[1]

familiar with the farm loans made and who knew the essential facts about the borrowers. Information was obtained from bank records wherever such records were applicable. Records on the 1950 borrowings of about 20 or 25 farmers were obtained from each bank. These borrowers were selected at random from those whose income came largely from farming and who got at least half of their income from cash crops such as cotton and peanuts. These two restrictions were intended to eliminate farmers whose off-farm earnings materially affected their financial status and those who had no particular problem in changing from a row-crop system.

In interpreting the results, it should be recognized that a bank's farm borrowers are not necessarily a typical cross-section of the farmers in the bank's territory. According to the farm census, for example, only 8 percent of the farmers in the area sampled had 100 acres of cropland or more, yet 46 percent of the bank loans were made to farmers in this group. This does not mean that the banks confined their lending to large operators. Farmers who had less than 50 acres of cropland accounted for 28 percent of the borrowers. These comparisons do show, however, that as the size of farm declines there is also a decline in the proportion of farmers who can use credit effectively and who can meet the requirements for commercial credit.

How the Money Was Used

Of the 621 farmers whose 1950 borrowing records were studied, 170, or 27 percent, used part of the money to begin or expand livestock or other enterprises besides row crops. Money was borrowed for

these purposes mostly by farmers with relatively large farms. Only 11 percent of the farmers with less than 80 acres of cropland borrowed for expansion of livestock, yet 42 percent with 80 acres or more borrowed for this purpose.

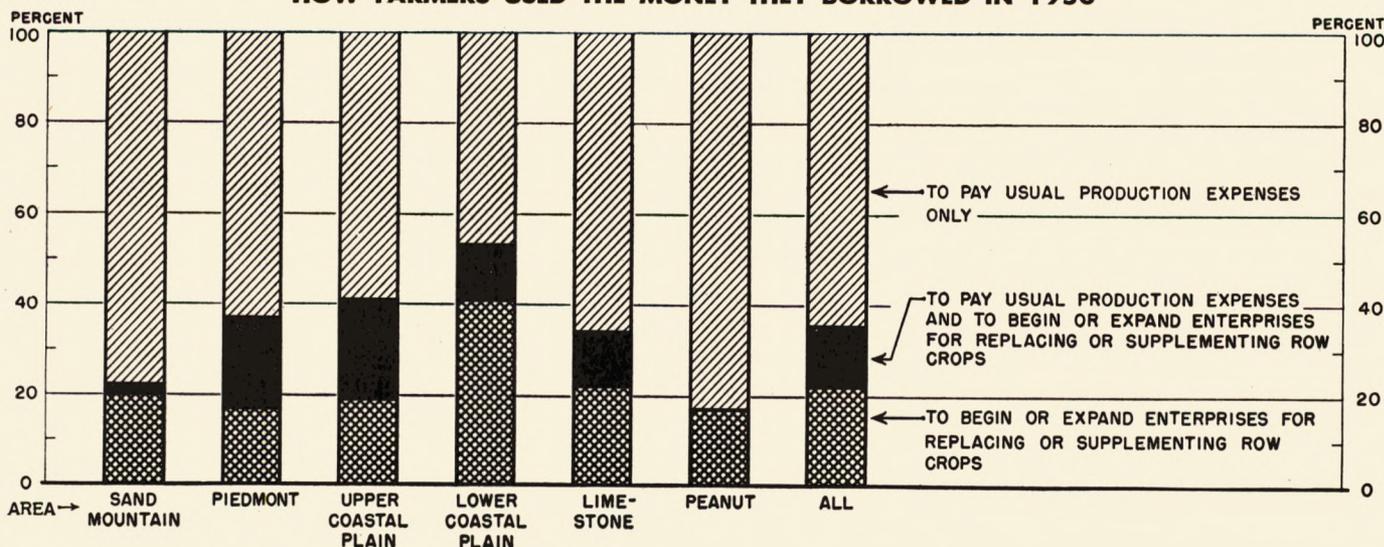
PERCENT OF FARMERS WHO BORROWED TO BEGIN OR EXPAND LIVESTOCK

Area	Farmers With Less Than 80 Acres of Cropland	Farmers with 80 Acres of Cropland or More	All Farmers
Sand Mountain	15	35	21
Piedmont	n.a.	50	31
Upper Coastal Plain	8	36	25
Lower Coastal Plain	n.a.	58	51
Limestone	10	44	26
Peanut	7	13	16
All Areas	11	42	27

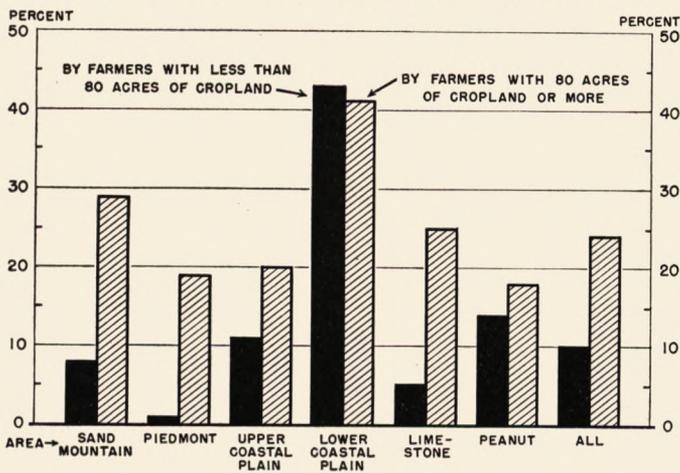
Most of the borrowing to expand livestock enterprises was to buy cattle or to help pay for pasture establishment and improvement. Since hogs are the most suitable livestock enterprise for the Peanut Belt and few farmers needed to borrow to begin or expand a hog enterprise, there was a relatively small proportion of livestock expansion loans made in that area.

Of the total amount of money borrowed, 65 percent was for usual production expenses, 22 percent was for livestock expansion alone, and 13 percent was for a combination of livestock expansion and the usual production expenses. Total borrowings refer to the total face amount of the notes made in 1950. For a particular farmer, total borrowings are usually greater than the maximum of the line of credit. Because livestock expansion loans usually have longer maturities than crop production loans do, total borrowings used as a measure of loan volume likely result in some understatement of the importance of livestock loans.

HOW FARMERS USED THE MONEY THEY BORROWED IN 1950



PERCENT OF TOTAL BORROWINGS USED FOR LIVESTOCK EXPANSION



The proportion of total borrowings used for expansion of livestock differs markedly according to the type of farming area. In the Lower Coastal Plain, 41 percent of the money borrowed was expressly for this purpose, and an additional 12 percent was used for a combination of row crops and livestock expansion. Only 47 percent of the money was borrowed for row crops alone. In the Piedmont area, only 17 percent was used for livestock expansion alone, but an additional 20 percent was used for a combination of purposes that included livestock expansion.

Farmers with less than 80 acres of cropland used 10 percent of their total borrowings for livestock expansion alone and an additional 2 percent for a combination of purposes that included livestock expansion. Farmers with 80 acres of cropland or more, on the other hand, used 24 percent of their borrowings for livestock and an additional 15 percent for a combination of purposes.

Amounts Borrowed

The average amount borrowed for all farms in 1950 was about 2,300 dollars. The individual amounts, of course, were closely related to the size of the farms. Farmers with less than 80 acres of cropland borrowed an average of 832 dollars, whereas those with 80 acres or more borrowed an average of 3,351 dollars. Al-

AVERAGE AMOUNT BORROWED

Area	For Crop Production	For Expansion of Livestock	For All Purposes
Sand Mountain	\$1,321	\$1,611	\$1,362
Piedmont	1,982	1,568	2,164
Upper Coastal Plain	1,828	2,847	2,249
Lower Coastal Plain	2,388	3,606	3,064
Limestone	1,981	2,651	2,276
Peanut	2,375	2,987	2,463
Total	\$2,017	\$2,553	\$2,297

though the average amount borrowed tends to increase with the size of the farm, measured by cropland acreage, borrowing increases at a slower rate. Farmers with larger acreages are able to pay a larger proportion of their usual operating costs and the costs of livestock expansion out of current income and savings.

On farms of comparable size in most areas, there was little difference in the average amounts borrowed for usual production expenses and those for expansion of livestock. Most farmers, of course, are stretching their livestock expansion program out over a number of years with the result that annual investments are small compared to the total cost of the program. Borrowings for usual crop production expenses averaged 2,017 dollars a farm; for livestock expansion alone, 2,553 dollars; and for a combination of both purposes, 4,970 dollars.

AVERAGE AMOUNT BORROWED

Purpose of Loan	By Farmers With Less Than 80 Acres of Cropland	By Farmers With 80 Acres of Cropland or More	By All Farmers
Crop production only	\$ 806	\$3,275	\$2,017
Crop production and livestock expansion	n.a.	5,652	4,970
Livestock expansion only	1,095	2,827	2,553
All purposes	\$ 832	\$3,351	\$2,297

Loans for livestock expansion in relation to those for crop production expenses usually were larger on small farms than on large farms. This difference is partly due to the tendency toward dairy cattle on small farms. To produce Grade A milk commercially, for example, a minimum investment is required for cows, barns, equipment, and pastures. Some of these

AVERAGE SIZE OF LOAN

Area and Size of Farm	For Crop Production Only	For Livestock Expansion Only	For All Purposes
Area:			
Sand Mountain	\$ 493	\$ 773	\$ 538
Piedmont	1,018	1,089	1,156
Upper Coastal Plain	953	1,603	1,126
Lower Coastal Plain	1,243	1,399	1,381
Limestone	773	1,686	955
Peanut	1,033	1,867	1,119
Size of Farm:			
Farms with less than 80 acres of cropland	365	634	386
Farms with 80 acres of cropland or more	1,340	1,590	1,455
Total	\$ 868	\$1,443	\$1,025

investments, such as that for a barn, must be made in a lump sum. The farmer who is expanding or beginning a beef-cattle enterprise, on the other hand, can make his investments at almost any annual rate he chooses. Also, there is some indication that larger farmers tend to expand their livestock enterprises on

a more conservative basis, in relation to their total investment, than do small operators.

Differences in the average size of individual loans were greater than differences in total borrowings. For farmers with less than 80 acres of cropland, loans for crop production alone averaged 365 dollars and those for livestock expansion averaged 634 dollars. For farmers with 80 acres of cropland or more, loans for crop production averaged 1,340 dollars and those for livestock expansion averaged 1,590 dollars. The average size of note also was related to the type of farm. Loans for crop production, for example, averaged 493 dollars in Sand Mountain and 1,033 dollars in the Peanut area.

Maturities

The net investment through bank lending during any given period depends partly, of course, upon the maturity of the loans. In this discussion the maturity as shown on the note is used. Many loans are repaid before the maturity date, but the maturity shown on the note is indicative of both the banker's and farmer's attitude and judgment. Of the loans for crop production, only 8 percent were written for one year or longer. Most crop production loans with long maturities were for the purchase of tractors and other machinery. Of the loans for the expansion of livestock, 25 percent had maturities of one year or more. The proportion of loans written for less than six months was about the same for the crop production loans as for livestock expansion.

Demand notes were used more frequently in connection with financing livestock expansion than with crop production. Most of these demand notes involved borrowing by large operators.

PERCENTAGE DISTRIBUTION OF NOTES BY MATURITY

Maturity	Crop Production Loans To			Livestock Expansion Loans To		
	Farmers With			Farmers With		
	Less Than 80 Acres Cropland	80 Acres Cropland or More	All Farmers	Less Than 80 Acres Cropland	80 Acres Cropland or More	All Farmers
Demand	1	1	1	..	4	3
Less than 6 mos.	30	35	32	36	30	31
6 to 12 mos.	62	55	59	53	38	41
12 mos. and over	7	9	8	11	28	25
Total	100	100	100	100	100	100

In most areas, the practice of making livestock expansion loans for a year or longer was more common on loans to large farmers than to small farmers. For farmers with less than 80 acres of cropland, only 11 percent of the livestock expansion loans had maturities of one year or more, while 28 percent of these

loans made to farmers with 80 acres of cropland or more had maturities of one year or over.

Renewals

The growth of bank lending for expansion of livestock has been accompanied more and more by a verbal understanding between the farmer and the banker that the loan can be renewed provided progress has been satisfactory. The actual maturities on notes for this purpose, therefore, do not always accurately indicate the length of the loan period.

In the areas studied, only 5 percent of the crop production loans were made with any understanding of a renewal at the stated maturity date. Most of these notes, furthermore, were for the purchase of a tractor and equipment. Of the loans for livestock expansion, on the other hand, 46 percent were made with some understanding about a renewal. Usually the farmer was expected to pay part of the loan at maturity date. The banker then advanced another loan for the remainder of the debt, provided the farmer was progressing satisfactorily with the livestock enterprise.

PERCENT OF LOANS WITH VERBAL UNDERSTANDING FOR RENEWAL

Area and Size of Farm	Crop Production Loans	Livestock Expansion Loans	All Loans
Area:			
Sand Mountain	9	36	14
Piedmont	8	50	17
Upper Coastal Plain	2	56	12
Lower Coastal Plain	4	24	12
Limestone	3	52	10
Peanut	9	71	16
Size of Farm:			
Farmers with less than 80 acres of cropland	6	29	8
Farmers with 80 acres of cropland or more	5	50	16
Total	5	46	13

For crop production loans there were understandings for renewals on 6 percent of the loans made to farmers who had less than 80 acres of cropland, and on 5 percent of those made to farmers who had 80 acres or more. On loans for livestock expansion, however, the renewal understanding was used more often on large than on small farms. There were understandings for renewal on 50 percent of such loans to farmers with 80 acres of cropland or more and on 29 percent of such loans to farmers with less than 80 acres.

Security

Chattels, or some combination of security including chattels, were used to secure most loans. Chattels alone were the security on 69 percent of all the loans made. The security taken on livestock expansion loans

differed from that on crop production loans in two important respects. First, a larger proportion of the livestock expansion loans was secured by only a chattel mortgage on livestock, and second, a large proportion of these loans was made on the farmer's signature, Government bonds, life insurance, and other similar security.

Nearly half of the livestock expansion loans to farmers with less than 80 acres of cropland were secured by livestock alone. On farms with 80 acres or more, livestock was the only security on about one-fifth of the livestock expansion loans. A larger proportion of these loans was made without specific collateral on the large farms than on the small farms.

PERCENTAGE DISTRIBUTION OF NOTES BY SECURITY

Security	Livestock Expansion Loans to Farmers With		All Farmers	All Crop Production Loans
	Less Than 80 Acres Cropland	80 Acres Cropland or More		
No specific security, no endorsement	9	16	15	11
Endorsement and combination including endorsement	0	4	3	7
Real estate and combination including real estate	2	12	11	8
Livestock alone	43	18	21	3
Chattels and combinations of chattels	36	42	42	68
Stocks, bonds, insurance policies	9	7	7	1
Other	1	1	1	2
Total	100	100	100	100

For all farms and all types of loans, real estate—or any combination of collateral including real estate—was used on only 9 percent of the loans. There were no significant differences in the frequency with which real estate was used between the large farms and the small farms or between the different types of loans. Most of the differences in type of security used were related to the size of farm and financial position of the farmer rather than to the purpose of the loan.

Income of the Farmer

Lending for livestock expansion is affected by the level of farm income as well as by the size of farm. For each of the farm borrowers studied, the banker was asked to estimate whether the farmer's cash income from the farm in 1950 was less than 3,000 dollars or 3,000 dollars or more. The 3,000 dollar figure was chosen because it was felt that few farmers with a smaller cash income could pay production expenses, obtain cash for family living, and have anything left for the retirement of a loan for livestock expansion.

A comparison of the bankers' estimates with other data on farm income seems to indicate that they are quite conservative. This may be due to the fact that

the bankers included in their estimate of cash income only those items of income that are ordinarily used to repay debts. Income from such enterprises as poultry flocks, for example, probably is not included. Although these income estimates are subject to some limitations, they do provide a reasonably accurate means of comparing groups of farmers.

Only 8 percent of the loans to farmers with an income of less than 3,000 dollars were for livestock expansion, while to those with an income of more than 3,000 dollars 33 percent were for this purpose. Even in groups of farms that were comparable in size, the purpose of the loans was affected by income.

On farms with less than 80 acres of cropland and with an income of less than 3,000 dollars, only 5 percent of the loans were for livestock expansion; loans for this purpose accounted for 16 percent of the loans on small farms that had more than 3,000 dollars of income. On large farms, 80 acres of cropland or more, 21 percent of the loans to farmers who had incomes of less than 3,000 dollars were for livestock expansion; 35 percent of the loans made to farmers with incomes of more than 3,000 dollars were for this purpose.

The relationship between income and purpose of loan differed markedly from one type of farming area to another. In the Sand Mountain area, loans for livestock expansion were made with the same frequency to the low-income groups as to the high-income groups. In the Peanut area, on the other hand, practically no loans for livestock expansion were made to farmers in the low-income group, while 15 percent of the loans in the high-income group were for this use.

PERCENT OF TOTAL NUMBER OF LOANS MADE FOR LIVESTOCK EXPANSION

Area and Size of Farm	Farmers With Incomes of Less Than \$3,000	Farmers With Incomes of \$3,000 or More	All Farmers
Area:			
Sand Mountain	15	15	15
Piedmont	16	36	28
Upper Coastal Plain	1	46	31
Lower Coastal Plain	17	58	49
Limestone	6	28	19
Peanut	*	15	10
Size of Farm:			
Farmers with less than 80 acres of cropland	5	16	7
Farmers with 80 acres of cropland or more	21	35	34
Total	8	33	23

*Less than .05 percent.

That bank credit was used less frequently for livestock expansion by low-income farmers does not necessarily indicate an important credit problem on the low-income farms. Most farmers who have low incomes have relatively small farms. Some livestock

enterprises—beef cattle, for example—often are not well adapted to a small acreage. The experience of agricultural extension workers and other similar technicians also indicates that, as a rule, farmers with small acreages and low incomes are less interested in livestock expansion and related farm adjustments than are farmers with relatively high incomes.

On low-income farms that are well suited to an expansion of livestock and where the farmer does want to make such an expansion, the mere existence of the low level of income, however, is a problem. The nature of this problem is shown by comparing the most probable income with the most typical amount borrowed for various size groups of farms. The income figures are derived from the bankers' estimates and from secondary sources. Farmers with 20 to 39 acres of cropland had incomes that exceeded borrowings by only 440 dollars. These farmers appeared to be using about all the credit that they could command simply to produce their row crops. Incomes exceeded borrowings by 870 dollars in the 40 to 59 acre group, by 1,660 dollars in the 60 to 79 acre group, by 2,640 dollars in the 80 to 99 acre group, by 3,450 dollars in the 100 to 119 acre group, and by 3,860 dollars in the 120 to 139 acre group.

Borrowings averaged approximately 10 dollars for each acre of cropland for all sizes of farms up to about 80 acres. On farms with more than 80 acres, the amount borrowed per acre tended to decline as the size of farm increased. Income, on the other hand, increased more for each acre added to the farms with less than 80 acres of cropland than for each acre added to farms with more than 80 acres. The average income of the farmers with 80 acres of cropland was approximately 3,000 dollars.

These relationships between size of farm and income and between size of farm and amounts borrowed indicate that farmers with low incomes are using bank credit more intensively than farmers with high incomes. On most of the low-income farms, a large increase in the amount of money borrowed for any purpose, including the expansion of livestock, probably could not be extended on commercially acceptable terms.

Refusals of Loan Applications

For each farmer on which a borrowing record was obtained, the banker was asked whether he had rejected any loan applications for expanding livestock and the reasons for not making the loans. So few rejections were reported that no statistical summary of the re-

sults could be made. None of the rejections were related to the purpose of the loan, the size of the farm, the income of the applicant, or the collateral offered.

Although very few loan applications were actually rejected, a large proportion of the bankers reported that they had worked closely with their farm customers in planning livestock expansion programs and in many instances had helped farmers to alter their original plans in order that the bank could help finance their programs. Farmers who planned to buy cattle before establishing pastures, for example, often were persuaded to establish the pastures first.

Current Farm Credit Problems

Since the extension of credit to farmers is a continuous process, a spot survey of the type reported on here can show only part of the results of that process. In spite of this limitation, however, these findings do throw some light on current farm credit problems. One question is whether or not bank credit procedures and bank policies are changing rapidly enough to keep pace with farmers' livestock expansion programs. If the borrowings in 1950 are assumed to be typical of the current trends in lending for livestock expansion, at least 25 to 30 percent of the borrowings each year at the banks surveyed is being used for this purpose. This rate of borrowings appears high considering that most of it represents capital investment.

According to the census figures on income, for example, Alabama farmers who got at least half of their income from field crops got only 10 percent from livestock. With respect to types of farms, these farmers are comparable to those included in this survey. Farmers' borrowings for livestock expansion, therefore, constitute a larger share of their total borrowings than the distribution of income would seem to indicate. These comparisons do not necessarily prove that banks generally are meeting the demands for livestock expansion credit. In the banks surveyed, however, it seems clear that such credit is receiving the attention that its importance justifies.

In many discussions of bank credit for livestock, much stress has been laid on the differences between this type of credit and that for financing row-crop production. Many of these differences are reflected in the findings of this survey. The survey seems to show, however, that these differences are far less important than many people outside the banking business have thought them to be. It is true that the investments usually required for livestock expansion are large in

relation to the usual crop production loan. The study shows that the farmer can grow into the livestock program rather than make the entire investment at once, and thereby keep the average size of his livestock loan comparable to the usual crop production loan. This procedure brings most farmers' livestock expansion programs into the range of commercial credit and is also desirable from a farm management standpoint.

Another difference between lending for livestock expansion and crop production that is often cited is the longer maturities required on livestock expansion loans. According to this survey the latter are written for somewhat longer maturities than crop production loans. The differences in maturities, however, are minor. The step-by-step procedure usually followed on these loans reduces the need for long-term loans. In instances where all the loan cannot be conveniently repaid within the stated maturity on the original note, understandings for renewals usually solve the maturity problem. These understandings, which were in effect on almost half of the livestock expansion loans, appear to be highly satisfactory in most respects. They insure that the livestock expansion program gets a thorough, periodic review by the banker and the farmer. They are based, of course, upon mutual confidence and understanding.

Bank lending to farmers was characterized by its flexibility. By adjusting the terms and conditions of the loans, the bankers were able to finance almost any livestock expansion program that was efficient from a farm management standpoint and that was being conducted by a farmer of good character. They were able to do this and apply prudent banking principles.

In order to make the large volume of livestock loans shown by this survey, many bankers had to make some innovations in their handling of loans. Generally those who had a good understanding of the farming business and of the credit problems peculiar to farming could make these innovations rather easily. This is not to imply that there are no problems in connection with appraisal of the farmers' programs, bank records, loan procedures, and the other technical aspects of farm credit. The main point is that these technical problems are not a particularly serious obstacle to advancement of credit for livestock expansion on the part of bankers who have a rather thorough understanding of farm lending.

In interpreting the survey findings, it should be kept in mind that all of the banks contacted had been

very active in farm lending for a number of years. Their accumulation of experience in making crop production loans was the foundation upon which they built their loan program for livestock expansion. Most of them have made loans to farmers within a wide range of net worth, management ability, and ambition. Country banks that have confined their farm lending to a few highly selected farmers whose credit requirements could be met in a routine manner and without any particular knowledge of farming on the part of the banker have a different kind of problem. The survey findings in regard to livestock loans are not applicable to banks in the latter group.

Farm Credit in the Future

Present indications are that the need for credit for financing the expansion of livestock as well as for crop production will continue to grow on District farms. As shown here, many country banks have already demonstrated their ability and willingness to meet farmers' credit needs. In these banks the policies of the officers and boards of directors toward farm lending are such that a continued improvement in loan procedures may be expected. Many country banks, on the other hand, are not following a policy with respect to farm lending that is conducive to the fullest agricultural development of their trade territories. How well banks meet farm credit needs in the future will depend partly upon the policies of individual banks or, stated in another way, upon the attitude of the banks' management toward agriculture.

Some banks that have done an excellent job of financing desirable farm adjustments up to the present are finding that their farm customers' needs for credit are growing faster than the resources of the bank. In these localities a form of capital rationing is appearing that may not be consistent with the best interests of farmers or of the entire community, state, or region. In a sense this development seems to reveal an imperfection in the capital market or in the structure of banking as it affects agriculture. The contribution of bank credit to farm prosperity, therefore, may also depend upon the ability of bankers, including those in the larger financial centers, to adapt the structure of banking to the greater need for farm credit that seems likely to develop.

The future of bank lending to farmers will also depend upon the circumstances and attitudes of farmers themselves. Farmers with low incomes and small

acreages, for example, probably will be able to use credit only to a limited extent to help finance such adjustments as the expansion of livestock. Innovations in farm credit will solve only a small part of the problems faced by these farmers. All bankers contacted were asked why they did not have more loans to farmers to expand livestock enterprises. Almost invariably the answer was, "The farmers haven't asked for

them." Most of these bankers have held meetings, visited farms, and tried in other ways to interest more of their customers in improving their farming systems.

In the last analysis, the initiative for all farm adjustments, including the expansion of livestock, rests with the farmer. The farm customers who had that initiative were obtaining the necessary credit at the banks surveyed.

BROWN R. RAWLINGS

Current Livestock Lending Policies

Since commercial banks are essentially community institutions, agricultural credit policies are influenced considerably by customs and traditions of farm life and rural communities. Credit policies, moreover, not only are the result of changes that take place on the farm and in town, but they shape the direction and rate of the changes themselves.

In the early days of commercial banking, decisions on individual farm loans and those regarding total farm loan volume were somewhat simpler than they are today. There was no question, for example, about a banker being interested in agriculture; there wasn't much of anything else he could be interested in. The few stores around the town square were borrowers, it is true, but their sales and collections were almost solely dependent on the ups and downs of farm income. Agriculture was the economic life of most rural communities.

Farming in most of the District was a comparatively simple operation. Even as late as the 1920's, the pattern was still similar to what it had been for almost a century—cash-crop production with mules and manpower. Neither farming nor farm lending, however, was particularly easy. Prices of commodities were erratic and the high degree of farm specialization increased risks. In most instances the banker took a calculated risk both as to production and price, and that, more than anything else, determined lending policy. If the borrower met that risk, he got his loan; otherwise he didn't.

There is, of course, a definite relationship between production patterns and bank lending policies. When tractors began to replace mules on cotton farms, the financing of them presented many new problems. The banker, for example, had to find reasonable answers to such questions as: On what size cotton farms will tractors be economical? What type and length of loan will best suit the borrower and lender? What is the collateral value of tractors and equipment? Aside from the questions raised in the financing of the tractor, however, were those that arose from changes in the production pattern of cotton. Where

tractors replaced mules, croppers were usually replaced by cash-wage hands at harvest, and that change in labor supply materially affected risks and costs.

In the decade of the 1930's, the control programs and the development of new market opportunities caused farmers to start diversifying. Each time a new crop was added to cotton or other cash crop, the lender had to appraise not only cotton production and tractor power, but the entire farm program. As these programs have become increasingly complicated, moreover, with the addition of year-round grazing, livestock, and seed crops, all the problems and combination of problems associated with them have found their way to the banker's desk. Because managerial capacity is much more important to the successful operation of diversified farm programs than it is in the production of a single cash crop, the borrower's managerial ability also had to be appraised. The number and type of decisions that call for the establishment of lending policies, therefore, have increased markedly.

Why Are Policies Necessary?

To explain what current farm lending policies are as they relate to livestock loans, it is necessary to answer the question, "What makes bankers do what they do?" Although it is difficult for anyone to explain in detail why he did or did not do something, the bankers contacted in a recent credit survey had rather definite reasons for establishing their lending policies.

Bankers make many decisions relative to farm loans, but not all of them could be termed policy decisions. When a decision has been made which applies to borrowers generally, however, that action decided upon becomes a policy. If a farmer were refused a loan for a tractor because of a lack of managerial ability, or because of his character, or some other individual consideration, such refusal might not, of course, be in accordance with a specific policy decision. On the other hand, if the bank required a 40 percent down payment and the balance in two years (as many do), that action would become a policy. If

the applicant were turned down because he lacked the down payment, the refusal would be in accordance with an established policy of the bank.

The difference between the two is important. Appraisal of an applicant against a policy is impersonal, at least to the extent that the borrower feels that the same yardstick will be used on all other borrowers. There is an understandable tendency for bankers to establish both positive and negative policies and, from a public relations standpoint, it is easier to handle a request based on general qualifications than one based only on personal characteristics.

The establishment of policies can make the job of lending easier and the use of funds more effective, because once a policy is thought out, it is not necessary to repeat the process with each new application. And, by the same token, as the number of specific policies becomes larger, the area in which individual appraisal is needed becomes narrower.

There is, moreover, another important advantage that accrues from making policies generally known; it saves time in the bank. If a bank makes it known, for example, that it will finance cattle only after pastures and grazing crops are established, then a farmer is not likely to come to the bank seeking a cattle loan until he has met that requirement.

A farmer can make excellent use of the bank's lending policies in planning his farm program. It is the policy of some banks not to extend credit for pastures and grazing crops until the area to be seeded is fenced. Thus, farmers in the areas served by those banks can plan their livestock expansion accordingly—first the fence, then the feed crops, and finally the cattle.

There is one consideration in making specific policies known to the community, however, that is looked upon unfavorably by some bankers. Once policies are established, the bank is obligated, at least in the borrower's opinion, to lend to all customers who meet those standards. But it may be that the capital structure of the bank and of the community is such that all prospective borrowers simply cannot be taken care of. Where that condition exists, it puts the bank and the banker in an embarrassing position to have to turn down some customers who have met the established lending criteria.

Who Makes Lending Policies?

Since banks do have farm lending policies, it is pertinent to ask who makes them and for what reasons.

Perhaps the most important group of people who help to determine lending policies are the farmers themselves. Their attitudes, ambitions, and opportunities determine what they want to do and influence their requests for capital. That does not mean, of course, that banks do not inspire and encourage farmers to adopt better management practices. Many do so. Their attendance and participation in the various types of farm meetings and programs, particularly those of the 4-H Clubs and the FFA, have been instrumental in encouraging farmers. But whether from county agent instruction, banker stimulation, or from whatever source, the farmers themselves must first want to do those things that require credit. This was demonstrated repeatedly in the credit survey when, on inquiry as to why there were not more livestock loans, the bankers replied, "People just haven't asked for them."

Next in order, perhaps, among the determiners of policy, come the bank executives. Their interest, knowledge, and foresight may determine whether the bank has lending policies and if so whether they are positive or negative. In no instance, however, did the study reveal progressive policies where the executive officers were not genuinely interested in agriculture.

Back of the officers, of course, come the directors. They are ultimately responsible for the bank policies and are instrumental in making them. Even when the officers are enthusiastic and want to try new procedures or new methods, the directors can stop them if they do not agree with them. Or, as in many banks, the policies may originate with the directors. Neither the officers nor the directors, of course, are completely free to make the rules of lending. State and national authorities prescribe the general boundaries of activity through laws and regulations and enforce them through examination.

Custom also plays a part in determining policies. Where a bank has become well known for its interest in farming, that recognition is a powerful incentive to keep abreast of changes and modify lending practices whenever necessary. Then too, competition of other banks or of Government-sponsored credit agencies has a bearing on the way a particular bank handles its loans.

What Did the Survey Show?

In order to ascertain how rapidly and on what terms farmers are seeking loans for livestock in their transition toward diversified farming, information was

obtained from 27 banks in sections representing the various types of farming areas in Alabama and Georgia. The banks were chosen because they had a sizable farm loan business; they are, therefore, probably above average. And for that reason their lending policies are probably a bit more tailored to the needs of financing livestock than those of the average commercial bank.

The study was not designed to obtain information on interest rates; nor is the purpose here to appraise the lending policies, but rather to explain them. And it should perhaps be emphasized that, with almost no exception, these policies are applicable only to the regular customers of the banks. The reluctance of banks to take on new borrowers, particularly for livestock loans, is due to the heavy demands of present customers, the desire to hold down the volume of loans in the present inflationary period, and the necessity of having a record of past performance on the borrower.

How Much the Farmers Asked For One of the first questions that arises in the borrower's mind is, "How much money will the bank lend?" The answer to that question depends on many variables, some of which involve bank policies, but the one thing that determines the amount of credit, more than any other, is the borrower's request. Only in rare instances did the banks surveyed require a downward adjustment in the farmer's estimate of his credit needs.

From the records of approximately 600 borrowers in the 27 banks, it is evident that, as a rule, the farmer expanding his livestock is using credit rather sparingly. His own conservatism plus the repeated advice of his county agent and others to *grow* into the business have made the farmer cautious. Generally speaking, the borrowers for livestock expansion may be divided into two broad classes; those seeking to substitute livestock for a part of their crop operations, and those who are adding livestock while maintaining their cash-crop program.

How much credit a farmer applies for to begin a livestock program or to expand an existing one depends on his choice of livestock, his experience, his own capital and collateral, and the rapidity with which he seeks to attain his goal. Apparently not many farmers who have had profitable crop operations wish to jeopardize their program or their financial position by biting off too much at once. That is evident from the amount of credit they have request-

ed. The amount of credit sought, as measured by total acres of cropland, was roughly the same per acre whether for cash crop production or for livestock. That suggests that the farmers, particularly those who are substituting livestock for crops, have evidently set some over-all credit ceiling for their farm which they are reluctant to break through. Undoubtedly they have been influenced by bank policy.

Then too, farmers are well aware that in the initial stages of livestock development, income is low and for a period their ability to repay loans is reduced. Those farmers who are adding livestock to their normal operations by clearing and draining land while not borrowing more per acre are borrowing on more acres. Hence, their credit totals are larger. In these instances, however, the farmers have advanced substantial amounts of the capital costs and have pledged additional collateral such as bonds and additional security by the assignment of life insurance. Many of the latter group have filed financial statements showing net worth of more than adequate coverage.

Obviously, there are many farmers who have no desire to add livestock to their program. Among them are tenants who lack security, old people who do not want to undertake new enterprises, small farmers who must farm intensively, and finally those who prefer cash-crop farming.

Farmers who have been refused a loan for livestock production have been, for the most part, of unsatisfactory character, or completely inexperienced, or have presented wholly impractical plans to the banker. Banks have shown a willingness to adjust the credit conditions to fit the borrower where the operation to be financed was practical and was within his managerial capacity to carry out.

How Much the Banks Granted The amount that banks are willing to lend on livestock is variable. These variations are accounted for by bankers' attitude toward livestock, by their experience in making livestock loans, and by market opportunities. Legal limits, moreover, both as to individual loans and total loans, are at present affecting lending by some banks. In addition, the amount of check-up or attention that banks can devote to their farm borrowers, ranging from none in some banks to quite a bit in banks with special farm men, has some bearing on the amount of credit granted.

Despite the wide variations in farm experience and net worth and despite a wide range in attitude and

bank experience, loans for livestock follow a fairly general pattern. In most banks the amount of money loaned for livestock, whether for animals, feed crops, or facilities, paralleled the amount loaned for crop production measured on a per-acre basis. Between banks, of course, the amounts varied widely.

The survey was not designed to determine the maximum amount that banks would lend, yet if the individual loans are divided by the total cropland of the borrower and reduced to a per-acre basis, a practical maximum can be determined. Using that measure, the amounts ranged from 10 dollars to a practical high of about 30 dollars. In three of the 27 banks the maximum loans for livestock were 38, 45, and 55 dollars per crop acre. These were special cases, however, each of which involved a real estate mortgage on the farm. The 55-dollar loan was for a period of four years. In most of the banks the ceiling for annual livestock loans, secured mostly by chattels, centered about 20 to 25 dollars per acre.

The policy of limiting annual loans for livestock to approximately the amount extended per acre for crop production is based on the recognition by bankers that there is little likelihood that per-acre returns from livestock will be higher than cash-crop returns. And it is that recognition of income potential that is responsible for bankers limiting credit extensions for livestock to a pay-as-you-go basis. Based on the coverage of the survey, it was only when borrowings exceeded this general limit that any real difficulties in lending practices or procedures occurred.

On What Kinds of Livestock Were Loans Made?

Because of the very rapid strides made recently in the production of forage, most of the current livestock borrowings are for grazing animals—beef cattle and dairy cows. Beef-cattle loans predominate not only because of the high interest in cattle, but also because of the availability of markets in practically every part of the District. The construction of auction markets and improvements in trucks and highways have brought the market within reach of all farmers. The wide dissemination of market information, moreover, particularly by means of the radio, has given most farmers flexibility in their choice of markets.

Loans for dairying, on the other hand, are limited because of market outlets. The market for Grade A milk, for example, cannot be expanded to all farm-

ers and, as yet, there are few processing facilities for manufacturing milk. Therefore, farmers who are not on milk routes, either Grade A or B, obviously are not interested in obtaining loans for dairy cows. There was, however, no reluctance to lend for dairying as such. On the contrary, banks usually preferred dairy loans, which were easy to collect because of the regularity of milk payments.

Basic to cattle loans, either for beef or dairy cattle, are loans for fencing, feed crops, and equipment. Because of the variety of such products and the wide range in their costs, their financing is geared to the income potential of the livestock and is within the over-all annual credit program of the farmer.

For Beef Cattle The amount of credit for beef cattle and the policies under which it is extended depend, substantially, on the type of farm operation. Because most farmers do not have abundant carbohydrate feed for finishing cattle, the cow and calf combination is by far the most popular of the beef enterprises.

With only minor exceptions, the banks surveyed would lend for the purchase of grade cows up to the limit of the feed available on the farm, provided the cost of the cows was reasonable and they were free of Bang's disease. Although loans were readily made for the purchase of purebred herd bulls, banks were reluctant to lend for the purchase of purebred beef cows. Moreover, banks were not inclined to lend for fattening cattle or for speculative purposes. Because of their special educational value, loans for 4-H and FFA cattle are handled differently from commercial cattle loans.

For Dairy Cattle Loans for dairy cattle followed a fairly uniform pattern. Where feed was available and where farmers were expanding, banks would finance the purchase of cows up to the number the farmer already owned. If a farmer had five cows, for example, the bank would lend for the purchase of up to five more cows. The usual practice is for the bank to take a mortgage on the herd and have the loan retired through monthly amortization by deductions from milk receipts.

The production of milk, particularly Grade A milk, requires a higher capital investment in buildings and equipment than does the production of cattle or hogs. But despite that, some workable procedure for handling the milk production loan is usually

made. Loans of this type, however, are usually made for a period of more than one year, or with an understanding for renewal, and are retired by applying alternate milk checks, or one-half of each, to the indebtedness.

What Are the Prerequisites for Livestock Loans?

Although the personal qualifications of a borrower are rather nebulous, there are certain general requirements which a farmer must meet. These requirements are applicable regardless of other factors that may be considered in granting a loan.

Character Always an important consideration in lending, character is unusually significant in lending for livestock expansion. As mentioned earlier, 46 percent of the total loans made for livestock expansion by the 27 banks carried verbal understandings for renewal. Obviously, such personal and unwritten understandings require that the borrower be honest and of the highest integrity. Just how much the policies governing character requirements have limited livestock loans is not known, but they are important. A few applicants for livestock loans were turned down by the banks surveyed because of their character, but they would likely have been turned down for any kind of a loan.

Experience Some experience in the raising of livestock was a prerequisite to obtaining livestock loans in all the banks. That does not mean, of course, that the farmer must have had experience of commercial proportions, but rather that he must know how to feed, breed, and care for the type of livestock he sought to expand.

Another, and the more stringent requirement, was that the farmer must have shown successful management of his cash crops. If he had shown increasing yields and efficient use of labor and machinery and had sought to build up the productivity of his farm, then it was felt he would extend those same management qualities to livestock. Conversely, those farmers who had shown little desire to improve their farms or yields were discouraged before a formal application for credit was made.

Tenure Since the proportion of farm tenancy in the South is generally high, the question of whether the region will ever become a livestock area is sometimes raised. The mere fact that a farmer has a ten-

ant status does not preclude him from obtaining livestock loans at the banks participating in the study. If he meets the other qualifications and has some security in his tenure, either by lease or long occupancy, then the banks have demonstrated that they will lend.

Size of Farm The size of a farm has little meaning except in terms of what it is producing and in comparison with other farms. In the preceding article, it was shown that 34 percent of all the loans made to farmers with 80 acres or more of cropland were for livestock purposes, whereas on farms of less than 80 acres only 7 percent of the loans were for that purpose. If 80 acres of cropland is considered a fair general division between large and small farms, then the larger farms are expanding their livestock much more rapidly.

Size of farm and income are so closely related that it is difficult to separate them. The majority of livestock loans have gone to the larger farmers mainly because of the popularity of beef cattle, which, in most cases, is not practicable on small farms. Most of the cattle loans were obtained by farmers who operated on about a hundred acres or more.

There are some cattle enterprises that can be successful on small farms, and farmers who sought credit for them were usually accommodated. One bank in a mountainous area, for example, made about a third of its cattle loans, based on a random sample, to farmers with less than 80 acres. Because of the high labor requirements and higher returns per acre, the production of milk is more feasible on smaller farms than the raising of cattle. The loans for dairying, therefore, were made mainly to farmers on medium-size farms of around 60 to 100 acres of cropland. In a few instances, loans were made on smaller farms, but these were for the production of milk for manufacturing purposes as well as for usual crop production.

On What Basis Were the Loans Made?

In making livestock loans, bankers are much more careful to itemize the particular purposes for which the money is to be used than they are in making crop production loans. Itemization is particularly important in working out maturity and amortization and in tailoring the loan to the need for it.

When financing beef cattle, for example, the banker and borrower sought to make the loan for a period of time and with a maturity date that would coincide with an income period. Since, on many farms,

cattle are sold in the fall when grass begins to die, maturity dates were usually made to coincide with that marketing period. Where no sales of livestock were contemplated within a 12-month period, the maturity date was adjusted to a crop-income period. In making dairy loans, repayment was amortized monthly or semimonthly regardless of purpose or maturity. In some instances repayment was delayed until production reached a certain level.

Maturity Although the practice of making a livestock loan mature in 12 months or less may seem an unrealistic policy when viewed from the purpose for which the loan was made, renewals have had the practical effect of extending what is usually termed "intermediate credit." Although the loan is due and callable on maturity date, the bankers said that they would not arbitrarily call them when to do so would force liquidation or sale at an inopportune time. The high percentage of renewals on livestock loans is evidence that the policy is working both for the lender and for the borrower. Annual maturities, moreover, give the banker and farmer an opportunity to review progress and perhaps head-off trouble before it becomes serious.

Collateral The differences in collateral required for livestock loans were not really the determining factors in making most of the loans. Sixty-nine percent of the total notes listing security for livestock loans were for chattels either on livestock alone or in a combination with other chattels. Only 9 percent involved a mortgage on real estate, and 12 percent were made on open note.

Appraisals Policies regarding appraisal of a farm and its equipment and livestock as a prerequisite to a cattle loan also were variable, particularly between banks. The size of the loan is, of course, very important. In some banks, particularly those which have special farm representatives, an appraisal of the farm and the farm program was customary. This was especially true where either the amount of the

loan or its terms required a real estate mortgage.

Generally, the banks required no complicated forms, schedules, or appraisal for the average livestock loan to a regular customer. If the loan were for a new customer, appraisals of farm and program were made.

Supervision Since for many banks the financing of livestock is a relatively new venture, some of them maintained frequent check upon the progress of the borrower. This was particularly true of banks with special farm men. These check-ups are most important, and while every effort is made to make them appear to be a casual visit, they are part of a definite policy. In some banks a report is made on these visits and appropriately filed; in others nothing is written. The methods by which this check-up is maintained are numerous; they include personal visits, riding the country roads and observing, and contacts with neighbors of the borrower. In none of the banks, however, did the bankers report any unfavorable reactions from the borrowers because of follow-ups on the loans. On the contrary, many of the banks reported that visits by bank personnel, especially farm men, were genuinely welcomed. The fact that many of the officers in rural banks have farms of their own on which they, too, are expanding livestock put the visits on a basis of mutual interest.

Summary

The credit problems arising from the shift from highly specialized crop farming to a diversified program including livestock, have been numerous and, in a few instances, vexing. Nevertheless, progressive rural banks have devised means and adopted policies that have made credit available for this transition without imposing unreasonable requirements or changing the basic policies that have governed their farm lending in the past. The high percentage of farmers who are currently using bank credit to expand their livestock enterprises is evidence that the policies of the banks are acceptable to the borrower.

JOHN L. LILES

Community Capital Accumulation and Farm Financing

From the standpoint of lending to farmers, the most important banks in the Sixth District are those in small towns. With a few exceptions they are unit banks that obtain almost all of their deposits from the local communities. A large proportion of their assets is in the form of loans to local businessmen and farmers. How much money one of these banks can and will lend depends to a large extent upon the ability of the businessmen, farmers, and other individuals in the community to accumulate bank deposits and upon the demands for loans that meet the requirements of prudent banking.

The ability to accumulate deposits depends partly upon the efficiency with which the land, the money, and the people are organized to produce goods and services of value. This efficiency, in turn, is importantly affected by the ability and willingness of the local banks to extend credit. This close relationship between the rural bank and the area which it serves has some important implications for farmers who use bank credit and for the whole banking system in the Southeast.

The discussion so far can be summarized in three tentative statements. First, the need for bank credit to expand livestock will continue to grow. Second, many country banks are already devoting a large proportion of their lending power to this purpose. Third, many banks have shown that they can adapt their lending policies to fit this type of credit and still conduct a safe and efficient banking business.

Bankers in some areas are finding that their deposits are not growing fast enough to permit them to grant all the farm loan applications that fall within their established lending policies. Farmers in these areas cannot borrow to the same extent as farmers in other areas for the expansion of livestock or for other changes in their farming systems. During the last two decades the structure of rural banking has undergone some sweeping changes, most of which have been

toward making it safer and more stable. The test of its adaptability to the credit needs of a changing agriculture has only begun. The purpose here is merely to point out some features of the structure of country banking that affect farm lending programs. No attempt is being made to appraise the effectiveness of banks in such financing.

The Problem

The problem that confronts many country banks is illustrated by the following example. A certain bank, located in a community where farming is the principal source of income, has always tried to grant the credit demands of farmers who, in turn, could meet the requirements for commercial bank credit. In so doing, it has built its volume of farm loans to a point where the management feels that any further loan expansion at the present level of deposits would be unsound. Until the past few years, most of the farmers got a large part of their income from row crops. As farmers began to expand livestock, the bank began to make loans for this purpose.

Last year it became apparent to the bank management that the bank could not follow through on the livestock program it had helped start and at the same time continue to finance crop production for all of its old customers. Since the farmers who were expanding livestock were making financial progress while many farmers who were growing only row crops year after year were not progressing financially, the bank decided to eliminate some of its row-crop customers. In this way the bank hoped to have more money to lend to the farmers who were expanding livestock. As the current crop season progressed, however, the remaining farmers who were borrowing for row crops began coming back for more money in order to meet the higher costs of production. As country bankers well know, a crop loan that falls short of assuring all of the materials for a successful crop carries a very high

risk. The bank, therefore, advanced about as much money for crop production this year as it did last year and is now in almost exactly the same position in regard to livestock loans as it was a year ago.

Another country bank, in similar circumstances, not only stopped advancing credit to some of its regular crop-loan customers but actually helped them to get jobs in towns and in industries located outside of the community. Many small, row-crop farmers simply cannot operate unless they can get credit.

The Capital Market

Banks, of course, do not lend to everyone who asks them for money. One of their main jobs as custodians of the pool of funds made available by the people of the community is to allocate the limited supply of money among those who can use it most effectively. A rationing of credit, therefore, is inherent in the very nature of the capital market. If the market were perfect, farmers could bid for credit against credit users everywhere or could go outside of their communities to borrow. Credit would be rationed to farmers in exactly the same way as for all other users and credit for a particular farming purpose, such as livestock expansion, would be weighed in the market against all other uses. In practice, however, credit for farming purposes does not always move readily from one community to another, nor can farmers, generally speaking, borrow outside of their own communities.

The market for non-real-estate loans to farmers is still primarily a local one. These loans are based largely upon the local banker's intimate knowledge of the individual farmer. This knowledge includes a good idea of the farmer's character, of his hopes and ambitions, of his management ability, both with respect to the farm and to his finances, and of the soundness of his farming program. Collateral is usually taken, of course, but it is not a substitute for this personal evaluation. Bankers often sum up this idea by such a remark as "If the man's not good, the loan's not good, regardless of how much collateral he can offer." A farmer who goes outside of his own community to borrow usually has to be an extraordinarily good risk in order to get a loan.

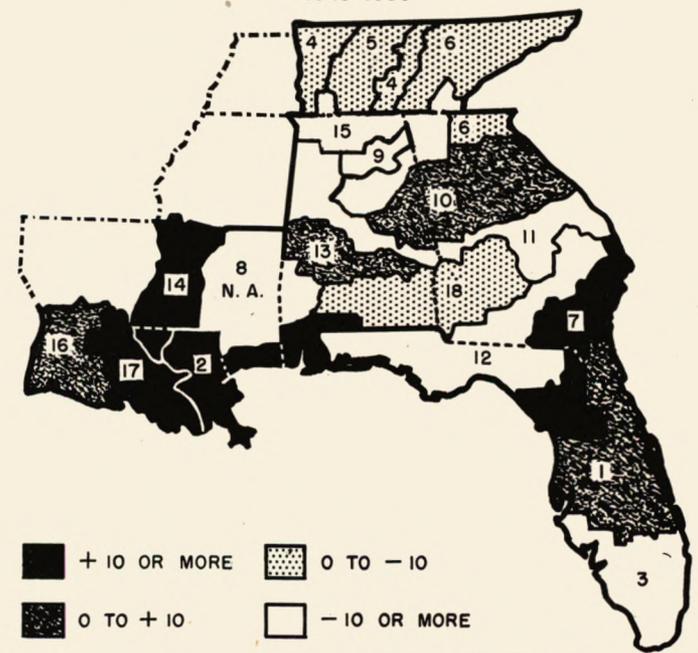
The growing importance of livestock loans tends to make farm lending even more local in character than before. These loans, as compared to the usual crop loans, require a more careful study of the farmer's entire program and considerably more supervision by

the banker. Often there is a tacit agreement between the farmer and banker about additional loans if a four- or five-year livestock expansion program is being financed. Collections, as in the case of dairy loans where payments are made by assignment of milk checks, may also depend upon the cooperation of local business interests. The market for these loans, therefore, seems likely to become even more local in nature.

The question of mobility of credit, or the ability of farmers to bid for credit in a national market, is very old as far as country banking is concerned. Many of the framers and sponsors of the Federal Reserve Act believed that the System would overcome the difficulty. The sponsors of the Government's farm credit system likewise believed that they had the cure. Although these systems have proved serviceable in dealing with emergencies in farm financing, they have not, at least in many areas in the District, provided a satisfactory permanent solution.

Country bankers' reluctance to borrow, either from other commercial banks or from the Federal Reserve Bank, prevents a free flow of funds from financial centers to rural communities. Although the reasons for this attitude vary from bank to bank, much of the

CHANGES IN TOTAL DEPOSITS
IN CITIES OF LESS THAN 15,000 POPULATION
1945-1950



- | | | |
|------------------|-------------------------|---------------|
| 1. Citrus | 7. Flatwoods | 13. Blackbelt |
| 2. Gulf Truck | 8. Ala.-Miss. Timber | 14. Silt Loam |
| 3. Winter Truck | 9. Sand Mountain | 15. Limestone |
| 4. Highland Rim | 10. Piedmont | 16. Rice |
| 5. Central Basin | 11. Upper Coastal Plain | 17. Sugarcane |
| 6. Appalachian | 12. Lower Coastal Plain | 18. Peanut |

attitude may be explained by the fact that country bankers do have a deep sense of responsibility for keeping their loan and investment policies within the capabilities of their banks. They want to have a "good strong bank." Bank supervisory authorities, in their efforts to make sure that banks are operated with due regard to the safety of deposits and, in general, in the public interest, have helped to shape this attitude of reluctance toward borrowing. From a practical standpoint, therefore, borrowing by banks is not very effective in meeting local demands for farm credit.

The Banking Structure

What are the main characteristics of the capital structure of country banking that affect the ability and willingness of banks to make farm loans? The amount and kind of deposits held by a bank, of course, are the most important. One banker facing a farm loan situation similar to that described earlier and who has about 5 million dollars in deposits said, "What we need is another 5 million in deposits."

Although bank deposits have increased greatly during the last decade, they have not increased at the same rate in all farming areas or even in all communities within any area. In some places they have actually decreased. From the end of 1945 to the end of 1950 in the Sand Mountain area, for example, deposits in banks located in cities having populations of less than 15,000 declined 22 percent, while deposits in cities of 15,000 or more declined only 4 percent. In the Blackbelt, on the other hand, deposits in the smaller cities increased 8 percent, while those in the larger cities decreased 2 percent.

According to the annual deposit ownership surveys made in this district, farmer-owned bank deposits increased 11 percent from the end of 1944 to the end of 1948. During the same period, farm income increased 43 percent. Deposits owned by other individuals, on the other hand, increased 25 percent during this period, while nonfarm income payments increased 23 percent.

The extent to which changes in the income of a community are reflected in changes in bank deposits, of course, varies according to its economic organization. In areas where a large proportion of total income comes from farming, the tendency of farmers to put excess earnings back into the farm business has tended to offset the effect of the increase in farm income on deposits. During the past few years District

farmers have bought, at an unprecedented rate, farm machinery, fencing materials, fertilizers, and other goods needed to improve their farms. Much of the deposit money that is created by loans for the purchase of such items flows out of the rural community.

Even where deposits in rural areas have grown rapidly, the demand for loans has often increased even more rapidly because of the increase in the cost of farm production. Part of this increase in cost is accounted for by price rises. From 1945 to 1950, for example, the national index of prices paid for items used in farm production increased 37 percent.

In addition, the ratio of cash costs to total costs has increased. This increase in the "out-of-pocket" costs of farming means that farmers are using more operating capital. A large share of the increase in farm production loans in recent years has gone to meet this need.

The ability of banks to lend is affected by the stability of deposits from week to week and from month to month as well as by the average amounts held over the course of a year. Deposits of country banks in cash crop areas usually follow a seasonal pattern that is almost exactly the opposite of the seasonal changes in the volume of farm loans. In the Sand Mountain area, for example, at banks in cities of less than 15,000 population, deposits declined 3.8 million dollars during the first half of 1949 and farm loans increased 1.1 million. Deposits and farm loans behave in much the same way in the Peanut area. In middle and eastern Tennessee, on the other hand, where farm income is about equally divided between crops and livestock, there is little seasonal fluctuation in either farm loans or deposits at country banks.

Individual banks have even greater variations in loans and deposits than the averages for a farming area would indicate. The banker whose deposits vary from 1.0 million to 1.5 million and whose farm loans vary from 100 thousand to 400 thousand dollars cannot base his loan policy on annual averages. If the low point in deposits coincides with the high point in loans, as is usually the case in cash crop areas, and if he hopes to keep total loans below some fixed percentage of total assets, he must base his lending policy on the low point of deposits. One of the very real difficulties is that he doesn't know, at the beginning of the year, what the low point in deposits is going to be. As deposits decline and as loans increase, he often comes to a point where he cannot take on any

more farm loan customers and still give the proper attention to loan diversification or to a proper ratio of loans to total assets. Furthermore, he must always be prepared to advance additional money to farmers who already have crop loans. In the cotton areas farmers often come back for additional loans with which to purchase insecticides and to pay for picking. These loans are almost always granted since repayment of the original loan on schedule depends largely upon the success of the crop.

How completely deposits can be mobilized for farm financing depends not only on their total amount and upon their seasonal variations, but also on how they are distributed among various owners. Most of the deposits in country banks are owned by individuals, partnerships, and corporations. At one country bank where these deposits amount to about a million dollars, over 40 percent were held in less than ten accounts of 10 thousand dollars or more each. At another bank of comparable size, on the other hand, only 5 percent of its deposits were in accounts of 10 thousand dollars or more. Obviously, the deposits of the former bank cannot be invested in quite the same way as those of the latter. In the first case, any erratic movement in a few accounts could alter the deposit picture appreciably.

The size of a bank's capital accounts affects farm lending mainly through its use in setting the legal limitations on the amount of credit that can be extended to a single borrower. Under state and national banking laws, the maximum credit that banks can have outstanding to a single borrower is set at a percentage of total capital accounts. In recent years there has been a marked increase in the number of farm borrowers reaching these limits. One by-product of farm mechanization and of the migration of workers from farms is that many a large land holding that was formerly farmed by croppers or tenants is now operated as one large unit with hired labor. The credit requirements that were formerly divided among several borrowers have now been concentrated on one.

Another reason for the increase in the demand for large loans is the increase in the scale of their business that has been made by many individual farmers. Many of today's large farmers were struggling ten years ago to pay for a small farm. Country bankers have, therefore, seen some of their best customers grow too large for them to finance. From the farmer's standpoint this limitation on the bank is probably of

little importance since many large farmers are not confined to the local market for farm loans. They usually have the kind of a financial statement and collateral that enables them to borrow rather easily outside of their home communities. Banks, furthermore, have been adding to their capital accounts during recent periods of favorable earnings. At the end of 1950 the average ratio of total capital accounts to total assets was the highest since the end of 1943.

Farm loans, of course, are only one kind of loan made by banks in rural communities. The severity with which farmers are rationed in their use of bank credit depends partly upon the banks' policies toward other classes of borrowers. These policies, in turn, are affected by the profitability of farm loans as compared to other types of loans. At an individual bank the relative profitableness of a particular type of loan may be affected by the kind of community it serves, by the kind of competition it has, by the aptitudes of its officers, and by a host of other factors.

Statistical comparisons do not show any significant differences between the proportion of total loans classified as farm loans as of a given date and the usual measures of the rate of earnings on capital accounts or upon total assets. Neither do they show any relationship between changes in the proportion of farm loans and changes in the rate of earnings. There is, however, a positive and highly significant relationship between the percentage of total assets accounted for by loans and the rate of earnings. Conclusive evidence on this point could be obtained only by such an accurate cost accounting on different types of loans as to be impracticable for most of the small country banks covered by this study. The data do indicate, however, that, on the average, the type of loans that a country bank makes does not greatly affect its profits. There seems to be no such clearly defined connection between the type of a bank's loans and the bank's profits as to require that farmers be rationed either more or less severely than other types of borrowers in the community.

Some Alternative Solutions

The foregoing characteristics of the structure of rural banking and the effect they may have on the adequacy of farm credit are pointed out for the purpose of raising questions rather than to suggest answers. If, however, it is true that farmers who use credit are adversely affected, some effects of possible solutions should be considered. When local banks fail to meet

what the business interests of the community believe to be their proper needs, one common solution is to organize a new bank. For the kind of problems raised here, however, an increase in the number of banks is definitely not the answer. The problems are most acute in areas where the banks have already gone "all out" to help finance agriculture. Merely to divide a community's deposits among more banks would not make more local funds available.

A second alternative, the borrowing by banks from other banks or from the Federal Reserve, has already been rejected. Although borrowing may again be used extensively to meet seasonal or emergency shortages, as it has been in the past, the understandable reluctance of country banks to remain permanently in debt seems to close this door.

Although some relaxation of legal restrictions on lending and some change in the policies of bank supervisory authorities might help banks in making certain kinds of farm loans, any possible benefits from such changes would certainly not be worth the sacrifice of the safety that the rules now give to depositors. The policies of country banks are influenced more by the commonly accepted principles of prudent banking than by any particular set of rules.

On the farm side, a greater diversification in the sources of farm income would allow banks in cash crop areas to use their available deposits more effectively. In areas where farming is now well diversified even small country banks usually do not experience wide seasonal swings in deposits or a bunching of loan demands into a short period.

In areas where income is fairly evenly distributed as among agriculture, industry, and trade, deposits can be used with the maximum efficiency. The use of

credit is needed to obtain either kind of diversification. In communities where income is derived chiefly from farming, however, and where most of the farm income is from one or two cash crops, the bank deposits upon which such credit can be based accumulate only slowly.

One of the best ways for a bank in such a community to get access to an outside credit market is probably through the correspondent relationship. Country banks have always relied upon help from their city correspondents in carrying large or unusual lines of farm credit. If this relationship could be made workable on farm loans that are not large or unusual, the structure of country banking and a slow rate of deposit growth in a local community would have little adverse effect upon farm financing. Certain practical problems would, of course, have to be solved. If loans, for example, could be kept on a local basis so that the personal relationship between a farmer and his banker could be retained, country banks would be able to do a better job of serving their trade areas.

No one of the more promising alternatives to the present system seems likely to afford a quick solution to the kind of problem under discussion. Over a period of years, however, some revision in the structure of banking and in the relationship among banks would undoubtedly prove beneficial to bankers as well as to farmers. Certainly there should be, and need be, no conflict between the present policy of restraining the expansion of bank credit and carefully planned steps looking toward greater mobility in the capital market so that the reasonable and necessary credit requirements of agriculture may be met effectively and economically.

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