Address of M. Monroe Kimbrel, Executive Vice President, First National Bank, Thomson, Georgia, and Chairman, Committee on Federal Legislation, American Bankers Association before the Mortgage Bankers Association, February 29, 1960, Conrad Hilton Hotel, Chicago, Illinois.

LOGICAL TEAM -- IMPROVED CREDIT SERVICES

As a commercial banker, it is a pleasure to meet with you folks from the Mortgage Bankers Association to discuss how we might better serve rural areas.

This is a distinct privilege for three reasons. First of all, you and your institutions are doing an extensive and excellent job of serving rural communities. You are effectively getting capital funds to rural areas -- funds which would not otherwise be obtained so efficiently. It's simply a pleasure to associate with you on that basis.

Second, your institutions and the ones I represent generally have financial structures which make it desirable for us to work closely together. This plus the changing nature of the financial structure of agriculture calls for our close cooperation.

Third, the financial world is faced with vital problems in which we both have an interest and a responsibility.

Financial Structures

Let's consider briefly the nature of the financial structure of our respective institutions.

Insurance Companies and Banks

From time to time, I believe we must remind ourselves that the liabilities of some of your organizations make it possible for you to specialize, to a degree, in long-term credit. Conversely, the liabilities of banks in rural areas are such that they tend to specialize in short- and intermediate-term credit for their farm customers. Consequently, a very effective working team has evolved.

As an example of this teamwork, approximately one-third -- or $1 billion -- of the $3 billion dollars of farm mortgages now held by insurance companies was "found" by banks or bankers, referred to insurance companies by banks or bankers, or in other ways serviced by banks or bankers before being recorded by insurance companies.

This significant volume of farm credit services has been handled in several ways. As many of you gentlemen well know, the working relationships between banks and insurance companies vary from (a) formally planned, legally documented transactions to (b) informal arrangements involving little more than a telephone call from a banker to a mortgage representative reporting that a certain farmer is seeking a mortgage on a sound basis.

Farms

As farmers come to need larger loans and longer repayment programs, the working relationship and bond between bankers and mortgage lenders appears destined to become more intense.

The changes which have necessitated larger and longer loans are obvious to most of you. Machinery and motor vehicles on farms are now about 2 1/2 times as great as 20 years ago as measured on a constant price basis. In other words, had we not had inflation, the real value of farm equipment would now be about 2 1/2 times the level of 1940.

It is also obvious that there are about 25% fewer farms for banks to serve than there were 20 years ago and that most of these farms are considerably larger.

Somewhat less obvious are the facts that farmers now spend about 14% of their cash farm income each year primarily for the replacement of capital items. This percentage has doubled since World War II.

In addition, farmers are giving up more and more of their cash farm income for annual-type cash farm production expenses. Since World War II this proportion has jumped from 50 to 65%!

Annual capital-type expenditures and production-type expenditures have risen so rapidly that the combined total now accounts for a higher proportion of cash farm receipts than existed during each of the depression years save possibly 1931 and 1932!

However, this adverse shift is not due entirely to declining farm prices and income. Of more significance to the future of agriculture and to farm credit, these figures reflect a long-run trend toward the cash purchase of more and more of the factors of production from off the farm.

In view of this major shift in farm financial matters, a close relationship between mortgage bankers and other commercial bankers will facilitate better services to farmers.

Interest Rate Problem

However, an interest rate problem threatens to destroy the incentive and the ability of mortgage bankers and of banking in general to service farmers' credit needs most effectively. By this I mean there are forces at play -- some of them politically motivated -- which tend to repress rate structures in rural areas. To the extent rates are reduced artificially, private lenders are forced to restrict credit to these areas. Consequently, farmers are deprived of fair access to the capital funds market. This is neither fair to private lenders nor to farmers!

But how, you may logically ask, do these insidious, repressive forces work?

You are all aware, I am sure, of extensive governmental interference -- perhaps a fraction of it justified -- in the field of farm credit. The Federal Land Bank associations, Production Credit Associations, Farmers Home Administration, and Rural Electrification Administration are notable examples of government encouraged or government sponsored agencies.

Now, I would be remiss if I did not digress for a brief moment and emphasize the fact that a great number of public officials -- both elected and appointed -- do have an understanding of the role of interest rates in our economy. They realize that farmers and others in our society can be served most effectively and fairly by freedom from distorting interest rate controls at a centralized level. Fortunately, many members of both political parties have the know how and the statesmanlike courage to encourage legislation in the best interests of our nation -- even when operating under the adversity of extreme pressure groups!

And, we would be self-deceiving if we did not recognize certain favorable qualities in each of the government encouraged or government sponsored agencies mentioned a minute ago.

Nevertheless, our history does bear evidence of governmental action leading to reactions which proved undesirable to our economy. Interest rates have been related to much of this governmental action and subsequent reaction.

For example, let's examine the rates charged by Federal Land Bank associations. As you gentlemen know, the FLBA's, as they are now named, are very competitive. And I hasten to add, we -- and I'm sure you -- are not against fair competition.

However, to a large degree, the competition we endure from Federal Land Bank associations is due to an unfair advantage given them more than 40 years ago by the Federal Government.

The Federal Land Bank System is exempt from most taxes. If Federal Land Banks and the FLB associations paid their fair share of taxes, as do banks of comparable size, the associations would have to charge an interest rate of about 1/2% more to maintain their present level of net income.

In addition, the System receives preferential treatment in the bond market. This favored reception of Federal Land Bank bonds reflects the affiliation of the Land Bank System with the Federal Government. Although Land Bank bonds are not legally guaranteed by the Federal Government, the money market assumes, and I think correctly so, that the Federal Government would come to the aid of the Land Bank System in the event of severe financial difficulty. Consequently, Federal Land

Bank bonds are accepted on the money market at an interest rate 1/4% to 1/2% lower than private financial institution bonds of comparable maturity and soundness.

The multiple impact of unfair tax privileges and of protection in the bond market is of great magnitude. Without tax privileges and government "sponsorship" in the bond market, the FLB associations would have to charge 3/4% to 1% higher interest to maintain the same net income after taxes!

Undesirable Effects of Subsidized Rates

The implications of these preferential treatments are severe and many-fold.

Subsidized rates are not in the best interest of farmers! This forthright statement may surprise many folks.

We must recognize that artificially low rates discourage lenders from serving farmers -- alternative lending opportunities to non-farmers become more attractive. Statistical measures do not help prove or disprove this concept. However, logic strongly suggests that if lenders can get a higher return elsewhere they will eventually tend to do so. This is true for individual investors such as retired farmers as well as for large institutions.

This is the situation some of you folks find yourselves in at the present time. It is a known fact that some insurance companies are closely examining their farm mortgage portfolios and wondering how they can justify a large farm mortgage volume. If insurance companies receive less than the fair market rate of interest, families of policy holders and individual investors in insurance companies will eventually suffer. It certainly is not fair to make widows and children of policy holders subsidize the interest rate on someone else's mortgages.

Recognizing the injustice forced on various groups of people by artificial credit practices, the American Bankers Association in 1959 adapted a credit policy on "Federal Government Lending." One intent of this statement was to instill in the public's mind, including bankers, a realization that interest rates serve society best and most fairly if permitted to fluctuate up and down as the money market rightfully dictates.

One section of that statement reads as follows:

> "Government lending programs, by favoring one economic activity or social group over another, often restrict the mobility of resources. They create hidden subsidies that perpetuate economic maladjustments. At times they encourage speculative use of credit..."
>
> "For the most part, Government lending programs have been developed on the premise that credit is not readily available from private lenders on "reasonable" terms. Unusually, the "reasonable" terms mean lower interest rates. This creates a bias in favor of interest rates below the levels that otherwise would prevail, and makes more difficult the problem of promoting a flow of savings sufficient to achieve a sustainable rate of economic growth."

Of course, the concept of relative freedom of interest rates does not mean that a degree of monopoly in an area or to a segment of the economy should be exploited by charging extremely high rates. Nor do we dare harbor tolerance for those who receive <u>extremely</u> high rates by concealing interest rates or otherwise practicing the art of deceit.

However, the A.B.A. credit policy statement clearly implies that a relatively free interest rate is a pretty good device for telling lenders where funds are needed and wanted. The statement also rightfully suggests that artificially low rates feed the fires of inflation by discouraging saving and encouraging over-investment to the point where the two get out of balance. We simply cannot have more investments than there are savings! Further, a sensible credit policy should indicate that any usurious abuses which may exist should be handled, if at all possible, by attacking the cause (the monopoly or the deceit) and not the effect (artificial interest rates per se). It doesn't make sense to fight a fire by squirting water on the flames!

What Can We Do?

Now, what can the institutions you and I represent do about the problems we have discussed?

Our first step, it seems to me, is to realize the nature of the financial structure of our respective financial organization. This realization leads to the conclusion that we can serve farmers and others most effectively if we work closely together. Happily, our common interest is also in the best interests of those we serve!

As to the interest rate problem, you can be assured that banking (acting through various groups including the Committee on Federal Legislation of the American Bankers Association) will do everything within its ability to attain a fair interest rate structure and to inform the public of the important role of the interest rate in our economy. As you know, the interest rate problem is partly banking and partly political. As far as subsidized rates are concerned, it will take a lot of persistent, effective encouragement to attain that fair, competitive environment which should be our goal.

Somehow, we must get across to the public and to legislators the idea that a fair, competitive rate provides an important guide to those managing or allocating capital funds.

In the matter of public education, as well as our main goal of serving the public most effectively, we have a common bond which demands our attention. By working together we can attain much!

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