WILL BANKS FORFEIT FARM CREDIT?

An Address Before

The American Bankers Association
Convention Workshop
Chicago, Illinois
October 1, 1968

by

Monroe Kimbrel, President
Federal Reserve Bank of Atlanta

During the relatively brief lifetime of each of us, we have seen agriculture change significantly. Everywhere we read about the great number of persons who have left farms and are crowding into our cities, and how farming has gone through a technological revolution. I have observed these changes in my native state of Georgia. You have found similar experiences in your area.

Bankers have also seen enormous changes in the practices of banking since World War II. Some of these changes have affected farm lending practices of banks directly; others have had equally important indirect effects.

Credit demands from businessmen and consumers, as well as farmers, have grown tremendously. From 1947 to 1967, total loans at commercial banks increased by 716 percent.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The deposit expansion was not nearly as great during this same period. Deposits increased 175 percent, with most of the increase occurring in time deposits. Demand deposits rose 95 percent; time deposits, 423 percent.

Because so much of the deposit growth came from time deposits, there has been a substantial increase in the cost of loanable funds. With deposits growing less than loans, the liquidity of most banks has been reduced. Twenty-two years ago, the loan-to-deposit ratios of reserve city banks and the country banks were 17 and 25 percent, respectively. By 1967, the ratios had increased to 63 percent for reserve city banks and 57 percent for country banks.

To illustrate this liquidity decline more vividly, total loans at reserve city banks increased nearly $110 billion; total investments were up less than $10 billion, with virtually all the increase coming in 1967 alone. At country banks, both member and nonmember, loans increased over five times; but investments were less than twice as large as in 1947.

These figures mean that practically every dollar of new deposit growth has been plowed back into loans.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Regardless of exactly how or what the future will turn out to be, right now all evidence appears to indicate a growing need for substantial amounts of farm credit.

Economists at the U. S. Department of Agriculture recently estimated that the United States population by 1980 might reach nearly 250 million persons. Feeding and clothing these people will require that food and fiber available for domestic consumption exceed present levels by over 25 percent.

Moreover, if income grows as expected, the ability of the average consumer to buy farm products will increase. It also seems likely that demand for American farm products from foreign countries will continue to grow.

Most of us believe that American agriculture can meet this challenge. This conclusion is based on advances in technology that have already taken place and that will undoubtedly continue to develop in the future. In fact, U. S. agriculture will probably meet this growing demand using fewer acres than today.

The highly capitalized and mechanized American agriculture that will produce this greater output, however, is going to be expensive to develop and expensive to operate. This means vastly

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

increased demands for credit. Now, what will be the source of this additional credit? admit - no vacuum

Today, farming draws on many sources for its financing. Commercial banks, although the largest single supplier, are not the only source. Undoubtedly, existing nonbanking institutions will continue to supply credit, and some of them enjoy peculiar advantages over commercial banks.

Production Credit Associations and Federal Land Banks have almost direct access to unlimited funds obtained through the national money markets. So long as the yields on the securities they issue remain competitive, they can draw the volume of funds needed to meet credit demands. Like all borrowers, they are affected by conditions of tight and easy money; but, over the long run, the individual unit has greater access to a supply of loanable funds for agriculture than the individual commercial bank.

In addition to having greater access to funds, the PCA's and FLB's, manned as they are by professional staffs especially trained in agricultural finance, may be able to provide the kind of financial counsel and service that will be needed by the sophisticated farmer of the future.

Professional staffs plus the specialized nature of the farm credit institutions place them in the position to skim off the cream

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the farm credit market. At the present time, for example, the average loan size for a PCA is $13,081 and for the FLB it is $25,070. At the commercial banks, the average farm loan is only $3,915.

Also, I should think that insurance companies will remain active farm lenders. Being unhampered by legal lending limits and the liquidity considerations characteristic of bankers, they are quite likely to seek out the best and largest farm real estate loans.

We have also noted an increase in the credit made available by trade concerns to farmers. Since farm suppliers and retailers will want to maintain their sales, they undoubtedly will make arrangements for supplying credit if institutional lenders should fail to meet the needs.

I should think it doubtful that the Farmers Home Administration type of credit will be as widespread in the future as in the past. The coming era of large and efficient commercial farmers possibly reduces the need for this type of financing.

Thus, although they will likely have problems, we should expect most nonbank suppliers of farm credit to be able to keep pace with future demands.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

On the other hand, for the future, the typical commercial bank that in the past has supplied the bulk of credit to farmers may be under certain handicaps. As we have noted already, bankers have been faced with rising costs for loanable funds, and their banks are less liquid.

In rural areas, the amount of loanable funds many independent bankers can secure is limited by their ability to attract deposits from their immediate areas only, and many rural communities are growing slowly.

These banks may experience real difficulty meeting the larger credit needs that will accompany the expanding capital requirements for agriculture. Moreover, their banks will continue to be plagued by problems of seasonally declining deposits at the very same time that demands for loans to farmers are increasing. While all of this is occurring, bankers who supply credit to farmers are probably going to find businesses and consumers also clamoring for more funds.

Because of these handicaps, should bankers abandon the farm loan market entirely? Or, if they do not abandon farm lending altogether, should they be content with what is left after other lenders have taken their pick? I believe the answer is, "No."

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In the short-run, some banks may gain more from high-return instalment loans than from agri-business and farm credit. However, this short-run gain could turn into a long-run loss.

Farm loans in the past have been good for banks. They have produced substantial revenues. More importantly for many smaller banks, they have helped support agriculture, which in their areas is the cornerstone of the local economy and local business. If for no other reason than that of self-preservation, bankers need to meet their share of the farm loan demands.

There are two possible general directions from which help can come to bankers wanting to maintain and improve their farm lending positions: from outside the commercial bank and from within the commercial bank.

From outside the commercial bank help may come from a proposed change in Federal Reserve discount policy. Most of you are aware that the Federal Reserve System has recently completed an extensive reappraisal of the Federal Reserve discount mechanism. In the process, it gave special attention to the problems of bankers closely identified with the provision of credit to agriculture.

The recently issued report on this reappraisal contains two provisions that, if adopted, can help banks lending to farmers.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

At the present time, the proposals are being discussed within the banking system and elsewhere.

Both of the proposals that affect banks specializing in lending to farmers are designed to reduce the need to maintain as high liquidity as in the past and thus to make it possible for the banks to divert more of their resources to farm loans. One proposal provides for a basic borrowing privilege which will enable the banks to adjust with greater facility to frequent but irregular deposit flows.

A provision especially useful to rural banks provides that those banks that experience deposit and loan levels varying in clear seasonal patterns, can negotiate for longer term credit up to nine months with the Federal Reserve Bank.

The rural banker, some persons suggest, might also be given aid through plans such as the formation of an institution for banks resembling a regional Federal immediate credit bank; however, this kind of arrangement does not seem imminent.

No matter how much help is offered from outside the commercial banks in order to make it easier for them to meet the demands for farm credit, action has to begin within the bank. The initiative must come from the executive offices and directors'

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

rooms within the individual banks; it cannot come from the Federal Reserve or some government agency.

A good many banks have already taken steps to meet more adequately the growing needs for farm credit. As a first step, some of them have as a matter of policy determined that they will maintain a substantial amount of their loans in the form of farm loans. In nonurban areas, other banks have actively solicited and obtained deposits of regional and national firms, agreeing in some cases to service the trade accounts for the corporate depositor or take over the financing formerly done directly by the trade concern.

A third avenue for improving farm lending has, of course, been an increase in the use of participation loans.

Some banks can expand the type of services that attract deposits and good farm loans by developing a special professional staff and offering services such as automated record-keeping systems or guidance in tax planning.

In any event, the final answer must come from top management at each bank if a bank is to be a leader in farm lending. This should not be a difficult decision once the problem is put into focus. All of these steps can be initiated within the bank.

I am convinced it is steps like those we have just briefly reviewed that will determine whether banks will recapture the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

ground they have already lost in their farm lending. Recapturing the ground lost in farm lending will be difficult at best; it will fail if the banking industry does not shoulder the major responsibility.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis