A review by the **Federal Reserve Bank of Chicago**

Business Conditions

September 1972

Contents

Directory of international organizations 2

The Farm Credit System 10

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

Directory of international organizations

It is almost impossible to read a major newspaper thoroughly nowadays without coming across names of organizations involved in international economic affairs. But even as this form of repetition increases public consciousness of these organizations, it is often difficult to retain a clear understanding of the functions of the many and diverse groups involved.

What has given rise to the proliferation of international organization since World War I has been an increasing awareness by national governments that the well-being of their economies are interdependent in matters of currency and trade. In the modern era of instant communications and jet-age "shoulder rubbing," more and more governments have come to recognize the need for formal rules to regulate multinational economic relationships. To date, it would seem, international organizations have proved the most effective mediums for accomplishing the objectives.

The purpose of this directory is to identify major international organizations now in operation, and to describe briefly their purposes and functions. It is hoped that such a listing will provide the interested reader with a concise "Who's Who" in the world of international organizations.

The directory divides the organizations into three categories based on their primary area of involvement. Although the stated objective and functions of any particular organization might indicate an overlap into more than one category, the three-part breakdown remains useful for an overview. The categories are:

- Organizations whose primary interest relates to monetary policy and financial matters.
- Organizations whose primary interest relates to development financing and economic and technical assistance.
- Organizations whose primary interest relates to international trade and regional development.

Monetary organizations

Bank for International Settlements (BIS). Most currently viable international organizations are of post-World War II vintage. The BIS, however, originated in 1930, growing out of the need for an organization to promote international cooperation among European central banks—a need stemming from difficulties experienced in the international administration of Germany's World War I reparations payments.

The bank, located in Basle, Switzerland, survived World War II, the reconstruction, and recurring international financial crises, and today continues as a highly-regarded institution for the coordination of certain multinational monetary arrangements, and serves as a pipeline for the exchange of information among major central banks.

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

Committee of Twenty (C-20). (See International Monetary Fund.) After the currency realignments in December 1971, the United States proposed that the International Monetary Fund develop a research and policy group more broadly based than the Group of Ten, one that would include representation from the less developed countries. A proposal to this effect was approved by the International Monetary Fund membership, and the Committee on Reform of the International Monetary System and Related Issues (C-20) met for the first time in September 1972 at the annual meetings of the International Monetary Fund in Washington, D.C. Membership in the 20-nation group is made up of the Executive Board of the International Monetary Fund —currently appointees of France, Germany, India, Japan, the United Kingdom, and the United States—and 14 representatives elected by the remaining 118 members.

Group of Ten (G-10). (See International Monetary Fund.) In 1962, ten major industrial countries—Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States—agreed to support the International Monetary Fund's General Arrangements to Borrow by lending their own currencies should that become necessary. Because of the group's dominant economic stature, it evolved into an important policy-making body within the International Monetary Fund. For example, the monetary realignments of December 1971 were basically a product of G-10 negotiations.

International Monetary Fund (IMF). First envisaged in July 1944 at the United Nations Monetary and Financial Conference[1] at Bretton Woods, New Hampshire, and implemented in December 1945, the International Monetary Fund today is the world's foremost organization dealing with international money matters. IMF policies formed the foundation for the postwar recovery of the international monetary system by fostering two goals simultaneously. One was to provide for the convertibility of national currencies in an environment of international stability. The other was to insure that individual nations could pursue independent monetary and fiscal policies. The IMF accomplished these goals through rules of conduct designed to promote the orderly operation of world money markets. Among the most important of these were procedures for borrowing reserves from the IMF, permissible exchange rate adjustments, the establishment of currency values in terms of gold or the U. S. dollar, and the elimination of exchange controls.

Over time, the IMF has been instrumental in developing policies conducive to the smooth functioning of the international monetary system and growth of world trade. It acts as a forum for cooperation among nations in monetary matters, and through its large staff of experts, as an advisory body particularly to small, developing nations. Since 1970, the IMF has acted as the administrator of the special drawing rights (SDRs)—a scheme launched to provide member nations with additional international reserves.

In 1972, the Fund, with a membership of 124 nations as of September 22, 1972, is undergoing profound change, as is the international monetary system itself. The suspension of convertibility of the dollar into

[1]The United Nations did not come into being until June 26, 1945—the reference to "United Nations" refers to a coalition of anti-Axis nations.

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

gold in August 1971, the temporary floating of most major currencies, and the renewed imposition of currency and exchange controls have struck at the heart of the IMF as it was originally constituted. But not only does the Fund continue to function, it has become the rallying point for governments looking for a new and reliable way to revitalize the international monetary system.

The Fund's day-to-day operations are supervised by the 20-member IMF Executive Board, which is made up of six appointees of major members and 14 elected representatives of the remaining members. IMF headquarters are in Washington, D.C.

The United States has dominated the operation of the Fund since its inception. But this influence may have wained somewhat over the past year due to the spreading power base represented by the Committee of Twenty, and the increasing economic power centered in Western Europe and Japan.

Financial assistance organizations

Asian Development Bank (ADB). The ADB headquarters were established in the Philippines in 1966 primarily to provide technical assistance and loans for capital and infrastructure development within non-communist Asian nations. Thirty-six countries are members of the bank—14 of them are non-Asian, primarily North American and European. A major part of the financial backing for the bank comes from Japan and the United States.

European Investment Bank (EIB). When the Treaty of Rome of 1957 created the European Economic Community, it also established the European Investment Bank, commonly called the European Bank. Originally, the EIB was thought of as a regional development bank that would restrict its lending activity to the six members of the Economic Community. It has since expanded its activities to associate members, Greece and Turkey, and other Community-associated nations—mainly former colonies of Common Market members.

The bank provides funds for development projects in less developed regions of the Community, for modernization or developmental projects of interest to all Common Market members, and for the furtherance of progress within the Community itself. Located in Luxembourg and directed by officials appointed by members of the European Economic Community, the European Bank functions as an autonomous public institution within the Community.

Inter-American Development Bank (IDB). Focusing on Latin America, this regional development bank grew out of pressures within Latin America for the establishment of a development bank specific to the region. It began in 1959, with headquarters in Washington. About 40 percent of the capital subscription comes from the United States. Development loans may be for social or economic purposes.

International Bank for Reconstruction and Development (IBRD). This is another world organization that grew out of the Bretton Woods Conference. Formed as a companion institution to the International Monetary Fund—and, like it, headquartered in Washington—the International Bank for Reconstruction and Development—often called the World Bank—was established to provide IBRD-member governments with a

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

source of long-term capital for the purpose of economic development. The bank obtains funds through subscriptions by member countries, bond offerings on various world capital markets, the resale of loans, and from earnings of active loans. From its inception through mid-1971, the World Bank had made loans of more than $16 billion in 89 countries.

International Development Association (IDA). An adjunct to the World Bank, the International Development Association, located in Washington, and administratively a part of the World Bank, was established in 1960 to provide long-term economic development loans specifically to the less developed countries. A major distinction between IBRD and IDA loans is that IDA loans are restricted to less developed countries, and repayment and interest terms are less rigorous than is the case for IBRD conventional loans. Developed countries supply most of IDA's capital subscription.

International Finance Corporation (IFC). The International Finance Corporation, another Washington-based and -administered adjunct of the World Bank, was established in 1956 to provide private firms in less developed countries with either loans or equity capital. Capital funds of the IFC come primarily from subscriptions of developed countries.

World Bank. See International Bank for Reconstruction and Development.

Trade organizations

The organizations in this category have their roots in trade agreements. They are mainly regional in orientation, having been formed as special trading blocs. Some have long since gone far beyond strictly matters of trade, and today function on principles of multinational economic cooperation and have as a goal full economic integration.

The Andean Group Common Market. In 1966, after it became clear that the five-year-old Latin American Free Trade Association was not progressing as rapidly as had been anticipated, the Andean group of nations took a small-scale approach to trade problems through a declaration of common objectives. In 1969, the common market concept was established formally with a 15- to 20-year plan to reduce internal trade barriers, to set common external tariffs, and to develop a common approach to regulating investment, trade, and banking within the area. Observers of the Latin American area are more optimistic about the potential success of the Andean Group Common Market than they are about other Latin American integration schemes. Its membership so far is limited to countries bordering the Andes—Bolivia, Chile, Colombia, Ecuador, and Peru. (Venezuela is associated with the group but is not a member.)

Central American Common Market (CACM). During the mid-1950s, the United Nations Economic Commission for Latin America proposed the idea of economic integration in Central America. In 1960, the work of nearly a decade was brought together in the Managua Treaty that established the Central American Common Market. Membership includes Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. While the countries of the CACM are similar in terms of their cultural, social,

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

and religious heritage—unlike the more diverse situation in Europe—moves toward integration in the area have been much more modest in scope than those of the European Common Market.

One of the major early criticisms directed toward the CACM, and toward other attempts at economic integration among less developed countries (LDCs), was that generally LDCs are producers of primary goods—raw materials and foods—and as such have little need to trade with each other. Reducing trade barriers through an LDC common market arrangement, it was claimed, would offer few advantages.

Nonetheless, a Brookings Institution study reported that intra-CACM trade increased about eight times between 1960 and 1968, and that a pronounced increase occurred in the share of trade among market members.[2] It seems beyond question that a substantial portion of these gains were achieved because the market agreed to eliminate internal tariffs on goods produced within the region, and to establish common tariffs against nonmembers. Another successful undertaking within CACM was the Central American Clearing House to handle currency clearings of members.

In recent years, progress in CACM development has faltered. During 1969, an armed conflict between two members—El Salvador and Honduras—halted progress within CACM. And in September of this year, Guatemala, El Salvador, and Nicaragua refused to admit goods from Costa Rica. With political tensions continuing in the area, the future of the CACM is tenuous.

[2]Grunwald, Joseph; Wionczek, Miquel S.; and Carnoy, Martin, **Latin America Economic Integration and U.S. Policy,** Brookings Institution, Washington, D.C., 1972, p. 45.

Council for Mutual Economic Aid (CEMA or COMECON). The Council for Mutual Economic Aid, commonly known as COMECON in the United States, is a Soviet-bloc organization with a common market orientation. Roughly equivalent to the European Economic Community, the CEMA places special emphasis on integration and coordination of economic planning and scientific research. Begun in 1949, the CEMA is currently in the early stages of a 15- to 20-year plan for attaining economic integration of member economies by the mid- or late 1980s. The CEMA, long dominated by the U.S.S.R. and with headquarters in Moscow, is made up of eight members—Bulgaria, Czechoslovakia, East Germany, Hungary, Mongolia, Poland, Rumania, and Russia.

European Common Market. See European Economic Community.

European Economic Community (EEC) or European Community (EC). During the postwar reconstruction of Europe, there was a broad-based desire for increased economic cooperation among nations. In 1951, six nations established a "common market" by pooling their coal and steel resources to form a free trade area. This first step at economic integration was called the European Coal and Steel Community (ECSC). For powerful forces within Europe, calling for broader-scale economic integration, establishment of a free trade area in two basic commodities was only a beginning.

The ECSC evolved into the European Economic Community, the official name of what is popularly known as the European Common Market. This successful economic integration plan began in 1958, with membership identical to that of the Euro-

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

pean Coal and Steel Community. Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands were the founders and shapers of the EEC. There has been no alteration in membership from 1958 through 1972. However, if the governments of applicant countries ratify pending agreements, membership in the EEC will expand to include Denmark, Ireland, Norway, and the United Kingdom on January 1, 1973.[3]

The most obvious accomplishments of the EEC in moving toward economic integration have been the removal of tariff barriers to trade among members, and the setting of uniform community tariffs on nonmember imports. Other accomplishments of the Community include the development of the Common Agricultural Policy (CAP), a uniform stance on agricultural policy (see **Business Conditions,** February 1970), freer labor force mobility among members and associate members, and increased commonality in tax systems (see **Business Conditions,** February 1971). The most recent, and if successful the most far-reaching, movement within the EEC concerns plans to establish a "common currency" and an implied common monetary-fiscal policy.

What was evolved in the EEC is far more than a free trade area. Today, the Common Market is a community of nations with a degree of integration that makes it an economic and political unit to be reckoned with on its own terms, quite apart from the nations of which it is composed. Headquarters of the EEC are in Brussels, Belgium.

[3]In a national referendum late in September, the Norwegian electorate voted to reject EEC membership. The final decision will be made by a vote in Parliament which is expected to follow the lead set by the referendum. Denmark will hold a binding national referendum on EEC membership early in October.

European Free Trade Association (EFTA). When the European Common Market was in the formative stage, several important European nations chose not to participate in the Community. Nonetheless, these governments were fully aware that the common external tariffs of the EEC would place individual nonmember states at a disadvantage in the European Community. Spurred by mutual concern, Austria, Denmark, Norway, Portugal, Sweden, Switzerland, and the United Kingdom established the European Free Trade Association in 1960, with headquarters in Geneva, Switzerland. In 1961, Finland joined, and in 1970 Iceland became a member.

Like the Common Market, EFTA sought a greater degree of international cooperation among its members, but, overall, its aims were much more modest than those of the Common Market group. EFTA's main objective was to eliminate tariffs and quota restrictions on industrial goods traded among its members. Unlike the long-range goals of the Common Market, EFTA's objectives stopped short of the integration of members' economies, and members retained full control over their own trade restrictions in relations with third countries.

The future status of EFTA is uncertain. Britain will terminate EFTA membership when it joins the EEC next January. In 1970, Britain accounted for 56 percent of EFTA-generated gross national product, and 43 percent of its world trade. Denmark and Norway have also negotiated a membership agreement, however, lack of public support within these countries may preclude them entering the EEC. (See footnote 3.) In that case, they will remain in EFTA.

The six EFTA countries that chose not to apply for Common Market membership engaged in negotiations with the EEC earlier

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

this year in an effort to obtain trade concessions to mitigate the economic impact of the association's reduced size. Denmark and Norway, if they do not become EEC members, may be expected to engage in efforts to obtain trade concessions from the EEC similar to those granted other EFTA countries. As EFTA develops a greater identification with the Common Market through special trading arrangements (some of which have been negotiated), thereby accomplishing adequate reductions in trade barriers, it may result in the eventual termination of EFTA as a formal organization.

General Agreement on Tariffs and Trade (GATT). In the immediate postwar era, the major trading nations of the world were quick to recognize the need for new rules to govern international trade relationships and the need to establish a forum for studying and discussing mutual trade problems. This was long before many of these governments began to view solutions to trade problems in terms of the integration of international trading patterns and even of national economies.

The United Nations sponsored the first major attempt to write new "rules of the game" for international trade following World War II. The International Trade Organization, proposed by the UN, failed to gain the necessary support and was dropped. Its aims and objectives, however, were attractive to 23 important trading nations. Independent of the UN, these Western European and North American countries, with the United States the driving force, worked out the General Agreement on Tariffs and Trade, and implemented the agreement on January 1, 1948. Today, GATT, with headquarters in Geneva, Switzerland, has 80 members, 15 nonmembers that adhere to its rules, and one provisional member.

GATT's primary purpose is to provide a framework of rules for international trade as free of governmental intervention and restriction as possible. To maintain this intermediary position. GATT calls for adherence to the most-favored-nation principle in trade and to the use of the GATT as *the* forum for settling disputes and for negotiating reductions in tariff and nontariff barriers to trade. Testimony to GATT's effectiveness is seen in two "rounds" of trade negotiations, one in 1960, the other in 1964, that resulted in significant and broad-scale tariff reductions. A third round of trade talks dealing with problems of nontariff barriers to trade is scheduled for 1973. (See **Business Conditions,** February 1972.)

GATT is unique among trade organizations. It has proved itself better able than any other organization to establish rules for international trade, and to provide recourse to injured member countries by sanctioning penalties that injured countries might apply to member countries that break GATT regulations. But GATT's toughest proving grounds may well lie in the future. As less developed countries (LDCs) have joined GATT, increasing pressure has developed for greater recognition of their trade problems. The domination of GATT by the major trading nations continues to frustrate many LDC efforts to obtain more favorable trade regulations vis-a-vis the developed nations. These trade problems are so troublesome in certain areas that the UN entered the picture directly through the United Nations Conference on Trade and Development. (See below.)

Latin American Free Trade Association (LAFTA). This Latin American version of the European Free Trade Association was

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

established in 1961. It encompasses Mexico and ten South American countries. Designed as an instrument of trade liberalization among member countries, its progress in this respect has been slow and its other accomplishments minimal. Originally, the free trade area was to be in operation by 1973, but that target date has been reset to 1980. Initial long-range plans to move all of LAFTA toward a common market have been all but sidetracked as emphasis within Latin America has shifted toward the development of more economically homogeneous groups of countries within smaller, more manageable geographic areas. (See the Andean Group).

Organization for Economic Development and Cooperation (OECD). In 1948, the Organization for European Economic Cooperation (OEEC) was established as a coordinating body for planning and administering Marshall Plan aid in the economic recovery of Western Europe. When recovery became a fact, the older body was replaced by the Organization for Economic Development and Cooperation. Today, OECD is a 23-member worldwide organization concerned primarily with analyzing a broad range of economic issues. Consulting and advisory functions are implemented through the efforts of working committees, such as the Trade Committee, the Economic Policy Committee, and the Development Advisory Committee. The potential for duplication between OECD committees and various other international organizations—for example the OECD's Trade Committee and GATT—is more apparent than real. Seldom does the Paris-based OECD go past defining, examining, and analyzing problem areas, and making recommendations for actions. Typically, these functions are undertaken as complementary to work being done by other organizations.

United Nations Conference on Trade and Development (UNCTAD). Frustration and dissatisfaction by the less developed countries with their treatment under the rules of GATT led to the development of the UN Conference on Trade and Development in 1964. UNCTAD, currently with 141 members, was conceived as an organization which could apply itself to the unique trade needs of the developing countries. It has, however, been restrained by the developed countries from duplicating the operational roles of other international organizations, especially GATT. With the possible exception of control over some international commodity agreements, UNCTAD functions largely as a forum at which the LDCs make their needs known, and where these needs can be studied and analyzed. Resolutions adopted by the heavily-weighted LDC membership of UNCTAD may or may not be adhered to by members, at their individual discretion, with no sanctions involved for nonadherence. Regarding effective action on trade matters of concern to the LDCs, GATT remains the important agency.

UN Economic Commissions. The United Nations has served as a springboard for a number of regional economic organizations. These organizations may be characterized as being oriented toward providing a forum for communications among members, and for promoting economic development within the region. These are: UN Economic Commission for Africa (ECA), UN Economic Commission for Asia and the Far East (ECAFE), UN Economic Commission for Europe (ECE), and UN Economic Commission for Latin America (ECLA).

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

The Farm Credit System

The Farm Credit System of the United States has provided more than $150 billion in financing to farmers and their cooperatives since its inception in 1916. This traditional lending role of the System, however, was augmented recently when the Farm Credit Act of 1971 authorized the System to make certain types of nonfarm loans. This new dimension, along with liberalization of its farm lending, suggests that the Farm Credit System will continue to grow rapidly, despite indications that the growth in farm debt may slow in the years ahead.

Structure and functions

The Farm Credit System encompasses a nationwide network of 37 cooperatively-owned banks and more than 1,000 local associations. Responsibility for the overall direction of the System rests with the 13-member Federal Farm Credit Board. Twelve of the Board's members are selected by the President of the United States, the other by the Secretary of Agriculture. The Farm Credit Administration—an independent agency of the U. S. Government—operates under the policies established by the Board and provides supervision, examination, and coordination for the System's banks and associations.

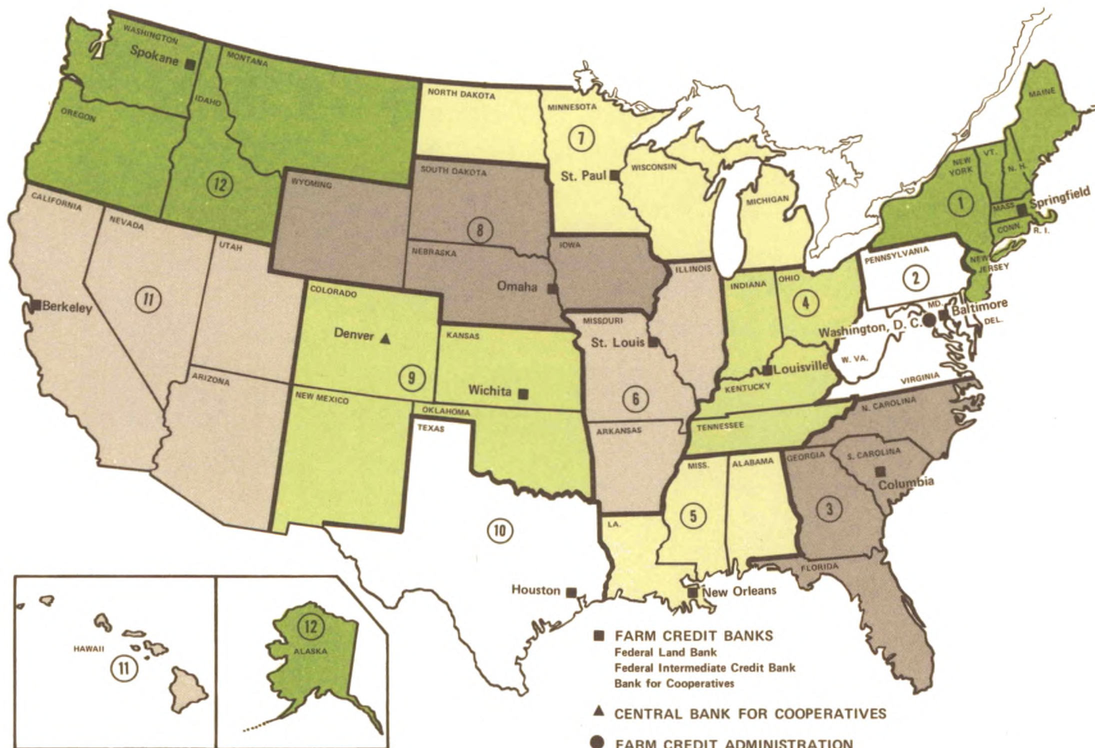
The banks and associations are spread over 12 districts. A Federal Land Bank, a Federal Intermediate Credit Bank, and a Bank for Cooperatives are located in a central city within each district. The additional bank, the Central Bank for Cooperatives, is located in Denver, Colorado. Throughout each district are numerous Federal Land Bank Associations and Production Credit Associations. These local associations link the System to individual borrowers.

The Farm Credit System provides three types of credit. The Federal Land Banks and the Federal Land Bank Associations provide long-term real estate loans. The actual loans are made by the Federal Land Banks. The Federal Land Bank Associations, whose membership is made up of the individual borrowers, process real estate loan applications and service the loans made by the land banks.

The Federal Intermediate Credit Banks and the Production Credit Associations join together to provide short- and intermediate-term production credit. The actual loans are made by the Production Credit Associations, whose membership consists of the individual borrowers. The funds for such loans are obtained by borrowings from, or discounts to, the Federal Intermediate

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

The 12 Farm Credit Districts



Credit Banks. The Federal Intermediate Credit Banks also make loans to, and discounts for, other financing institutions serving agriculture.

Banks for Cooperatives lend directly to farmer-owned cooperatives engaged in processing or marketing farm products, purchasing or distributing farm supplies, or providing farm services. The Central Bank for Cooperatives lends to large farm cooperatives whose borrowing needs exceed the lending capacity of the district Bank for Cooperatives.

The majority of the funds used for lending by the banks within the Farm Credit System are obtained through the sale of bonds and debentures in national money and capital markets. Other funds are ob-

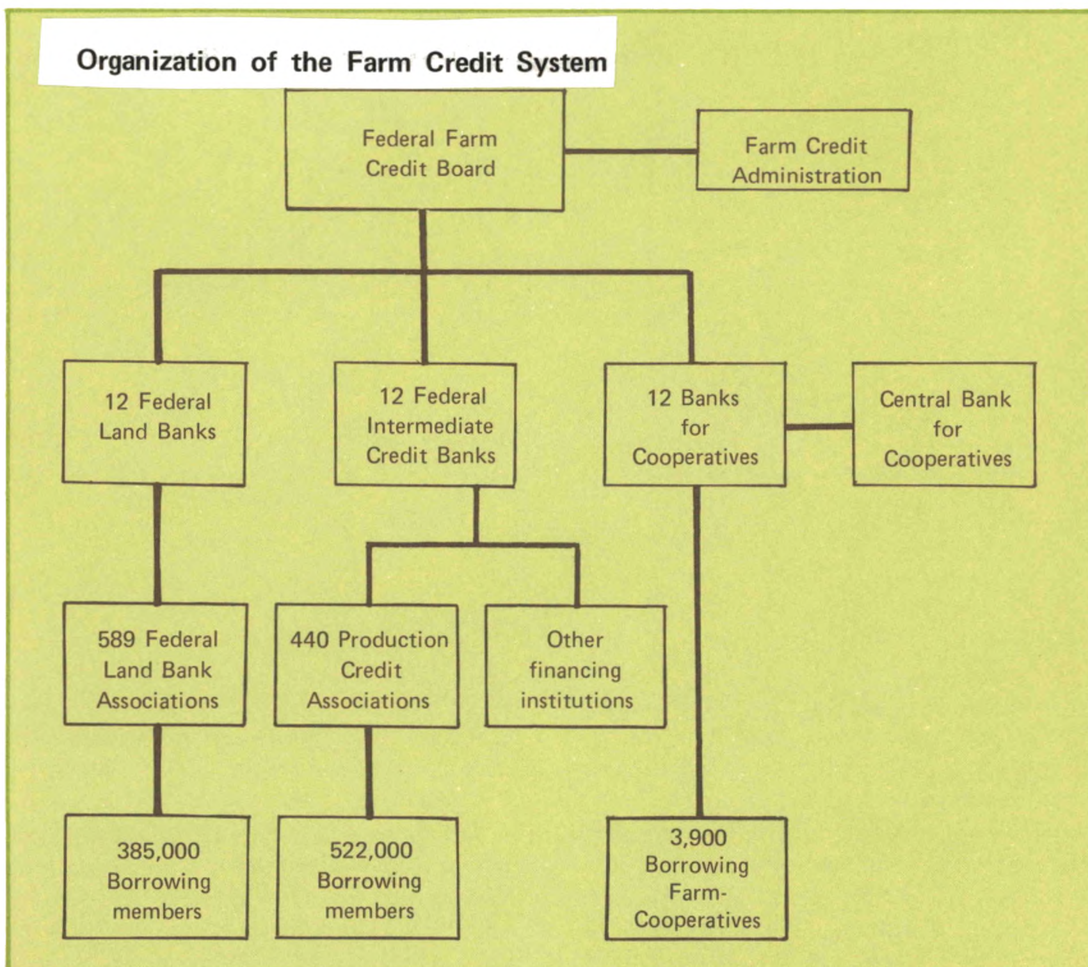
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

tained from earnings, and from the sale of investment bonds to individual borrowers and employees.

Evolution of the Farm Credit System

The availability of credit in rural areas was inadequate to meet borrowing needs in the early years of this century. Many rural banks were small and undercapitalized. And prior to the establishment of the Federal Reserve System in 1913, rural banks did not have a reliable access to funds from sources outside their communities. The seasonality of rural borrowing needs and the lack of funds flowing between surplus and deficit areas often resulted in comparatively high interest rates on agricultural loans.

Maturities on agricultural loans in the early 1900s were short, and repayments were not geared to income flows or the production period of the enterprise being financed. Three- to five-year real estate loans were common and, indeed, prior to the Federal Reserve Act in 1913, national banks



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

were precluded from making real estate loans for longer than five years. With such short maturities, foreclosures on delinquent loans rose sharply when agricultural income declined for any extended period. And because farm loans for operating purposes were often collateralized by real estate, even temporary declines in farm prices could jeopardize a farmer's entire land holdings.

Such problems led Congress to enact the Federal Farm Loan Act in 1916. This act marked the first systematic participation of the federal government in any type of cash lending activity, and became the cornerstone for today's Farm Credit System.

The land banks

The Federal Farm Loan Act of 1916 established the 12 Federal Land Banks (FLBs). The act authorized the land banks to make fully amortized farm mortgage loans with maturities of up to 40 years at interest rates not to exceed 6 percent. The National Farm Loan Associations (now known as Federal Land Bank Associations), also established by the act, were set up to process loan applications and service loans made by the land banks.

All 12 of the Federal Land Banks were organized and in operation by 1917. The initial capital structure of each bank totaled $750,000 ($9 million in total), with practically all of the funds coming from the federal government. In 1932, the federal government subscribed to an additional $125 million in FLB stock to help offset a depressed market for FLB bonds—the primary source of funds used for lending. The following year, in conjunction with emergency measures to reduce the large volume of foreclosures during the Depression, Congress appropriated still another $189 million to the FLBs' paid-in-surplus account. The FLBs drew upon this latter appropriation for several years, and in 1939 outstanding government capital in the land banks reached a peak of $314 million.

Retirement of the government capital was effected by a plan which required land bank borrowers to purchase stock in their local associations equivalent to 5 percent of the loan they received from a FLB. The local association, in turn, used the funds from the sale of its own stock to purchase an equivalent amount of the land bank's stock. By 1947, all government indebtedness was retired, and the land banks, for all practical purposes, have been completely owned by farmer-borrowers ever since.

In addition to providing capital, the federal government found it necessary to provide the land banks with other sources of funds during their early history. These additional funds came from Treasury deposits in the land banks, and through Treasury purchases of land bank bonds. Still other funds came from the purchase of land bank bonds by such government agencies as the Federal Farm Mortgage Corporation and the Production Credit Corporations. At times, the funds provided by these sources were substantial. For example, the $212 million of land bank bonds held by the U. S. Treasury in 1920 represented nearly two-thirds of total land bank bonds outstanding.

Production credit

The production credit arm of the Farm Credit System developed in several stages. The 12 Federal Intermediate Credit Banks (FICBs) were established by the Agricultural Credits Act of 1923. This act directed the Secretary of the Treasury to subscribe to the capital stock of these banks in an amount not to exceed $5 million per bank

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

($60 million in total). Additional capital provided in later years pushed the government's peak outstanding capital in the FICBs to $126 million.

The intended function of the Federal Intermediate Credit Banks was to improve the ability of private lending institutions to provide intermediate-term financing to farmers at reasonable rates. This was to be accomplished by discounting eligible paper submitted by commercial banks, agricultural credit corporations, livestock loan companies, and other specified institutions engaged in lending to farmers. Eligible paper included notes, drafts, bills of exchange, debentures, or other such obligations which were direct evidence of funds advanced by the institution for agricultural purposes. To finance the discounting operations, FICBs were empowered to sell debentures in national money markets.

Although it was expected that commercial banks would be one of the major users of the FICB discounting privilege, bankers were reluctant to do so. In part, their reluctance reflected the upper limit on interest rates banks could charge on loans to their customers and still meet eligibility requirements for FICB discounting. According to the 1923 act, the margin between the interest rate specified on paper discounted by a Federal Intermediate Credit Bank and the FICB discount rate could not exceed 1.5 percentage points. (In turn, the FICB discount rate could not exceed the rate on the last issue of FICB debentures sold by more than 1 percentage point.) Since this margin was not wide enough to include prevailing lending rates, bankers limited their use of the FICB discounting privilege.

Another factor limiting the attractiveness of FICB discounting was the generally more favorable terms Federal Reserve System member banks could obtain by discounting agricultural paper through their regional Reserve bank. Federal Reserve banks did not impose a maximum limit on the margin between their discount rate and the interest rate on discounted paper. Moreover, the Federal Reserve discount rate tended to be lower than that for the Federal Intermediate Credit Banks, and the Federal Reserve's definition of eligible paper tended to be broader than the FICB definition.

Several attempts were made during the late Twenties and early Thirties to offset the limited use of FICBs by commercial banks. The margin between the interest rate on eligible loans and the discount rate was raised to 3 percentage points, and FICBs were granted the authority to make direct loans to institutions otherwise eligible for discounting privileges. In addition, other institutions were granted the privilege of obtaining funds from the FICBs. But despite these measures, the volume of discounting and lending by FICBs continued to lag original expectations. Finally, Congress passed the Farm Credit Act of 1933, which significantly expanded the role of the Federal Intermediate Credit Banks.

The 1933 act authorized the establishment of 12 Production Credit Corporations, one for each farm credit district. The Production Credit Corporations were empowered to charter local Production Credit Associations (PCAs) and act in a supervisory capacity over them. The local PCAs were charged with the responsibility of making short- and intermediate-term farm loans. To obtain funds for lending, PCAs were granted the privilege of discounting their loans with the FICBs.

Government-subscribed capital to the Production Credit Corporations totaled $120 million. The majority of this was to be

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

used to purchase the stock of the local PCAs in each district. Additional equity in each local association was to be provided by borrower purchases of PCA stock—a requirement instituted to pattern retirement of government capital in Production Credit Corporations after the plan used for the land banks.

Further changes came with the Farm Credit Act of 1956. This act merged the Production Credit Corporations with the Federal Intermediate Credit Banks and provided a plan for repayment of the consolidated government capital so that the FICBs ultimately would be owned by the local PCAs. At the time of the 1956 act, most of the PCAs were already borrower-owned, and by the end of 1968 the remainder of the government capital in the FICBs was retired. Since then, the entire production credit arm of the System has been owned by farmer-borrowers.

Banks for Cooperatives

Although Banks for Cooperatives formally emerged in 1933, their functions within the Farm Credit System started in 1923, when FICBs were established and authorized to discount eligible paper from agricultural credit and marketing cooperative associations. Because these discountings proved small, Congress included the authorization for Banks for Cooperatives (BCs) in the Farm Credit Act of 1933. The act called for the establishment of 12 district Banks for Cooperatives and a Central Bank for Cooperatives located in Washington, D. C. (recently moved to Denver, Colorado). The district BCs were authorized to lend directly to the farmer-owned cooperatives in their district. The Central Bank for Cooperatives was designed to lend to large farm cooperatives whose operations covered more than one district, and to participate in large loans made by district BCs. Funds for BC lending were to be obtained by borrowing from, or discounting with, FICBs and commercial banks, and through the sale of consolidated collateral trust debentures to investors in national money and capital markets.

The original capital for the Banks for Cooperatives came from the government-provided Agricultural Marketing Revolving Fund—a fund established in 1929 and later transferred in part to the BCs. At the peak, outstanding government capital in the Banks for Cooperatives totaled $178 million. Additional equity capital was to be provided by borrowing cooperatives with the ultimate objective that this source of equity could eventually be used to retire government capital. This was completed in 1968.

The 1933 act established broad lending authorities for the Banks for Cooperatives. Eligible loans to farm cooperatives included (1) long-term loans for the construction or purchasing of buildings and other capital assets, (2) operating loans for inventories, supplies, etc., and (3) loans to facilitate the marketing of commodities or the purchasing of farm supplies. Interest rates and maturities varied by the type of loans, as did the stock purchase requirement placed on the borrowing cooperatives.

Growth of the System

The Farm Credit System has recorded remarkable growth, especially since the early Fifties. Total loans or discounts outstanding nearly tripled in both the Fifties and Sixties, and by mid-1972 amounted to nearly $18 billion. Of this, over $15 billion—or nearly one-fourth of total farm debt outstanding—represented direct loans to farm-

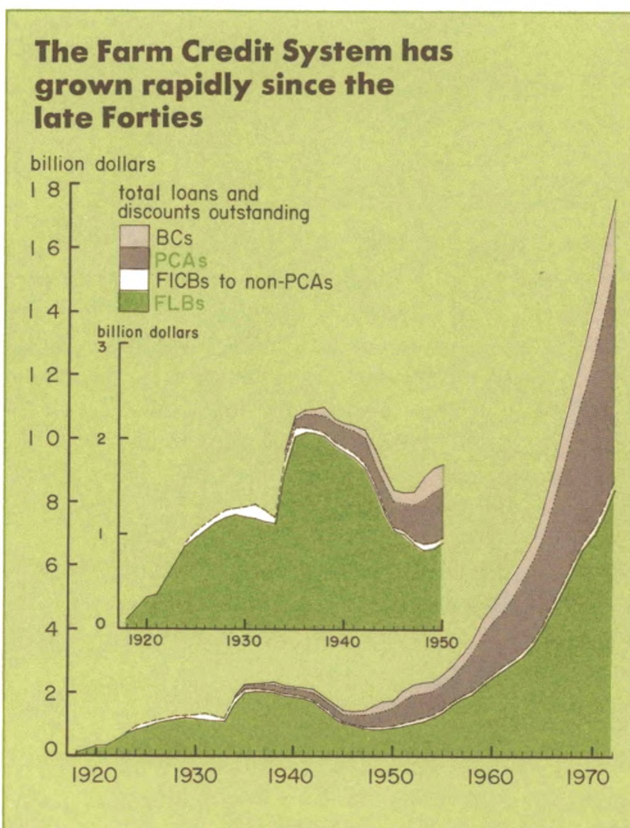
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

ers. The remainder represented outstandings at Banks for Cooperatives and FICB loans and discounts to non-PCA institutions.

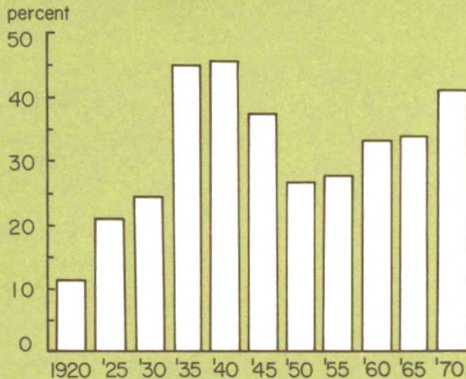
The land banks are the largest part of the Farm Credit System and the leading institutional supplier of farm real estate financing. As of mid-1972, loans outstanding among the 12 FLBs totaled over $8 billion. This accounted for approximately 25 percent of total farm real estate debt and nearly 44 percent of all institutionally-supplied farm real estate debt.

Lending activity of the land banks showed erratic patterns during the first three decades of their existence. Temporary declines in the market demand for FLB bonds resulted in sharp reductions in the amount of new money loaned by the land banks in the early Twenties, and again in the late Twenties and early Thirties. Congressional action, however, provided rapid recovery—especially in the Thirties. The latter recovery reflected several factors. Funds available for lending rose sharply, reflecting large government appropriations to FLB capital, bond purchases by other government agencies, and a decision to make FLB bonds the consolidated liability of all FLBs (thus improving investor demand). At the same time, congressional concern over the sharp rise in farm foreclosures during the Depression led to authorizations permitting FLBs to (1) lower maximum interest charges in both outstanding loans and new loans to 3.5 percent, (2) eliminate late-payment penalty charges, (3) suspend principle repayments for a period of five years, (4) make loans to liquidate the indebtedness of farmers with mortgaged land, and (5) raise the maximum loan to any one borrower from $25,000 to $50,000. These provisions caused a surge in the demand for FLB loans which, combined with the greater availability of funds, allowed the FLBs to extend $730 million in loans during 1934 —a record that held until 1963.

Following the mid-Thirties, new money loaned annually by the FLBs dropped sharply to a rather stable average of around $60 million until 1945. But since then, new money loaned annually has trended steadily



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



FLBs have long been a leading institutional supplier of farm real estate financing

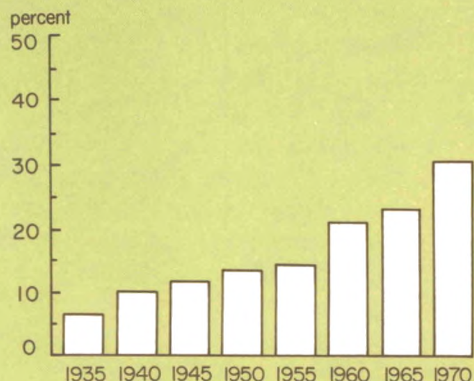
upward, reaching a total of $1.7 billion in fiscal 1972.

Despite fluctuations in lending behavior, outstanding farm real estate loans at FLBs rose steadily until interrupted by shortages of lendable funds in the late Twenties and early Thirties. But in conjunction with the emergency measures during the Depression, outstandings at FLBs rose sharply to over $2.1 billion by the end of 1936. This level, which represented over 30 percent of total farm real estate debt, was not surpassed until 1959. Following the mid-Thirties peak, FLB outstandings declined until the late Forties—reflecting repayments on the large volume of loans made during the Depression and the retirement of government capital—and then nearly tripled in the Fifties and the Sixties.

Outstanding loans and discounts at Production Credit Associations totaled nearly $7 billion as of mid-1972. This represented approximately 18 percent of total non-real estate farm debt and 31 percent of institutionally-supplied non-real estate farm debt. In addition to the PCA outstandings, FICBs held $300 million in loans to, or discounts for, non-PCA institutions at midyear.

Unlike the land banks, growth in PCA lending has trended consistently upward. Outstandings at PCAs increased 2.5 times during both the latter half of the Thirties and the decade of the Forties. Thereafter, the rate of gain in outstandings picked up sharply, rising to a near 3.5-fold gain in both the Fifties and Sixties. These growth rates outpaced both the gains in total non-real estate farm debt and the gains in such debt provided by commercial banks—the leading institutional supplier of non-real estate farm debt. As a result, PCAs have continuously absorbed a larger portion of the non-real estate farm debt market.

Banks for Cooperatives, like PCAs, have shown strong and consistent growth in their lending. Between mid-1934 and mid-1939, loans outstanding at BCs increased nearly threefold, followed by a nearly fourfold



. . . PCAs steadily increased their share of institutionally-held non-real estate farm debt

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

increase during the Forties. The rate of expansion slowed during the Fifties, but again accelerated during the Sixties. As of mid-1972, outstanding loans at Banks for Cooperatives totaled $2 billion.

New act portends further growth

Prior to 1971, the legal framework supporting the Farm Credit System was entangled in a host of separate acts and amendments. The Farm Credit Act of 1971, however, completely rewrote the statutes governing the System. But more importantly, the 1971 act defined new lending provisions which will provide a broader base for future growth of the Farm Credit System.

The most noteworthy changes in the 1971 act are those that expand the definition of "eligible borrowers." The act authorized both FLBs and PCAs to make loans to rural nonfarm residents, and loans to farm-related businesses. Loans to rural nonfarm residents are restricted to financing the purchase, construction, or remodeling of moderately-priced, single-family dwellings that are permanently occupied by the borrowing owner. The total amount of such loans outstanding at any FLB or PCA may not exceed 15 percent of its total loans outstanding. Loans to farm-related businesses are restricted to the financing of those assets or activities used by the business to perform custom-type, farm-related services on the farm.

The act further liberalized the definition of "eligible borrowers" by authorizing PCAs to participate in eligible loans made by commercial banks and other lenders, and authorizing Banks for Cooperatives to lend to farm cooperatives whose membership is composed of at least 80 percent farmers, compared to the previously more restrictive 90 percent requirement. Another liberalizing feature of the 1971 act grants FLBs the authority to lend up to 85 percent of the "appraised *market* value" of the real estate securing the loan. Prior to this change, land banks were restricted to 65 percent of the "normal *agricultural* value" of the mortgaged real estate. Both the higher percentage and the revised basis for evaluating real estate will tend to boost FLB lending.

Projected System growth to 1980

Projections of future developments are rarely accurate. Differing analytical techniques and underlying assumptions often yield widely varying results. Nevertheless, projections can provide signposts that point up the general outline of particular developments at some juncture in the future. Such is the case in any projection of the future growth in farm debt and the amount of financing by the Farm Credit System.

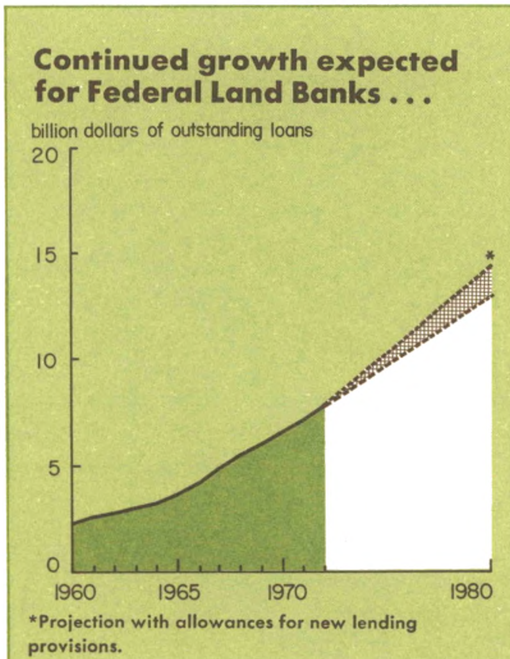
Total farm debt outstanding currently is estimated at about $65 billion and divided about equally between non-real estate loans and loans secured by farmland. While the magnitude of change in farm debt is uncertain, it is clear that the upward trend has not run its course. One recent study projected that total farm debt would reach $107 billion by 1980.[1] This implies a somewhat smaller annual rate of growth in total farm debt than that experienced during the past two decades mainly because of an expected slowing in real estate financing. A separate study currently in progress suggests that real estate debt will account for 41 percent of the total farm debt by 1980 and non-real estate debt will account for the remaining 59 percent. Assuming the pro-

[1]Emanuel Melichar, "Aggregate Farm Capital and Credit Flows since 1950 and Projections to 1980," Agricultural Finance Review, vol. 33, July 1972.

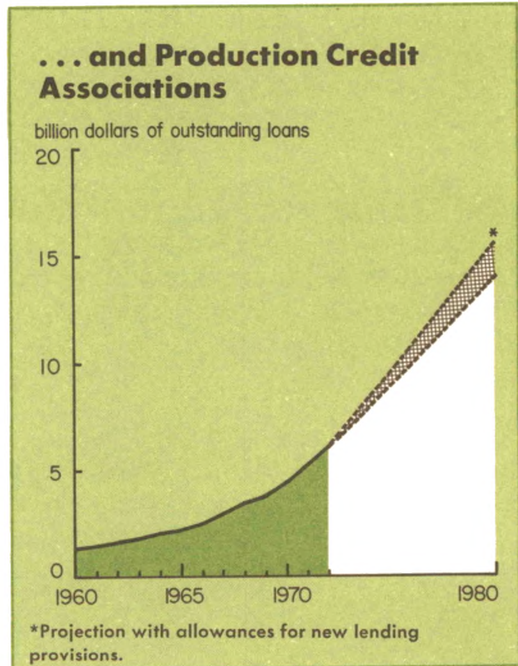
Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

jected $107 billion in total farm debt is realized, farm real estate debt would total $44 billion and non-real estate debt would reach $63 billion by 1980.

Federal Land Banks currently account for 25 percent of total farm real estate debt outstanding—up from around 19 percent in 1960. PCAs, on the other hand, account for over 18 percent of total non-real estate farm debt outstanding, compared to less than 12 percent in 1960. If FLBs and PCAs continue to enlarge their share of the farm credit market at the same rates as they have since 1960, the land banks' proportion would rise to around 29 percent by 1980, while PCAs would increase to nearly 23 percent. The combined projections of $107 billion total debt and of the proportional breakdown between real estate and non-real estate debt would imply that FLB loans outstanding to farmers would reach approximately $13 billion by 1980. Similarly, outstanding PCA loans to farmers might exceed $14 billion.



*Projection with allowances for new lending provisions.



*Projection with allowances for new lending provisions.

The change in the 1971 act, permitting FLBs to lend up to 85 percent of "market value," may cause FLB loans to farmers to grow at an even faster pace than indicated. In 1945, FLBs were authorized to raise their loan-to-value ratio from 50 to 65 percent of the normal agricultural value. This was followed by a sharp uptrend in new money loaned annually. Whether or not that experience will be repeated following the most recent change is difficult to foresee. However, the large portion of FLB loans made at the maximum ratio in recent years suggest that FLBs will have an incentive to utilize the more lenient rules.

The new provision permitting PCAs to participate in loans made by commercial

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

banks and other lenders should also tend to boost PCA loans to farmers. Although there is evidence suggesting that banks may be reluctant to use such arrangements, it is possible that much of this reluctance will dissipate by 1980. Moreover, since a significant number of rural banks currently use loan participation arrangements with correspondent banks, it seems reasonable that PCAs likely will attract at least a portion of the farm loans carried by banks under such arrangements.

The new provisions in the 1971 act authorizing PCAs and FLBs to make rural nonfarm housing loans and farm-related business loans may well contribute significantly to the amount of credit extended by these lenders over the next several years. While the volume of rural housing loans legally could reach an upper limit of 15 percent of total outstandings, an apparent reluctance on the part of some PCAs and FLBs likely will hold such lending to a smaller amount. And while the amount of farm-related business financing is not subject to an upper limit, the restricted scope that the law provides for this lending makes it doubtful that such activity will represent a large part of total lending by FLBs and PCAs. Opportunities for such financing will exist and undoubtedly increase over the next few years. However, it will take time for the FLBs and PCAs to develop the expertise needed to evaluate such loans.

While little basis exists to accurately project the overall impact of the new provisions on PCA and FLB outstandings, it is certain that the new lending authority will add to the expanding amount of credit extended. Thus, it is quite likely that the total credit (including that extended under the new provisions) outstanding at PCAs and FLBs at the end of the decade will approach, and could well exceed, the $30 billion mark. BC outstandings and FICB loans and discounts to non-PCA institutions could add an additional $5 billion to this total.

Overall, the Farm Credit System is sure to achieve substantial growth during the current decade. Despite a projected decline in the rate of growth in total farm debt, which would slow the growth in loans to farmers provided by the System, such loans undoubtedly will continue to represent a larger portion of total farm debt. Moreover, the new authority to extend certain nonfarm loans could easily hold the System's growth rate in total outstandings close to the rate of expansion which has prevailed since the Fifties.

BUSINESS CONDITIONS is published monthly by the Federal Reserve Bank of Chicago. Jack L. Hervey was primarily responsible for the article "Directory of international organizations" and Gary L. Benjamin for "The Farm Credit System."

Subscriptions to **Business Conditions** are available to the public without charge. For information concerning bulk mailings, address inquiries to the Federal Reserve Bank of Chicago, Box 834, Chicago, Illinois 60690.

Articles may be reprinted provided source is credited.

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