

**FEDERAL RESERVE BANK  
OF DALLAS**

July 7, 1925.

**RELATION OF CREDIT POLICY TO CROP OUTLOOK**

**To the Bank Addressed:**

The protracted drouth which at present is seriously affecting a substantial area of the Eleventh District's cotton belt has caused many of our member banks located in that portion of the district to become gravely concerned over the outlook for the 1925 crops.

The presence and menace of acute drouth conditions at the beginning of the growing season, when the banks are in the early stages of financing the new crops, have naturally led to a great many of them to give consideration to the possibility of a crop failure and its possible consequences to the producers and to the banks that finance them. In the light of these possibilities it is believed that a frank discussion of the relation of bank credit policy to the crop outlook would be appropriate and timely, and might perhaps be helpful to those of our member bankers who have not yet definitely determined to what extent, if any, they should alter or re-form their program of credit extension for the current year to conform to the changed conditions.

When a community is confronted or threatened with a crop failure, there usually arises a local demand for what may be termed "distress loans." While it is not possible to formulate or apply a "blanket credit policy" applicable alike to all applications for loans of this character, and while each case must be dealt with upon its own merits, it is possible to use certain proven credit principles as a basis for analyzing each application for advances of this kind.

We fully appreciate and approve our member banks' desire to "take care of the community" in an agricultural crisis insofar as they can do so **without assuming more than their own share of the burden and hardships incident to a local crop failure.** The equitable distribution of the burden as between the banks, their depositors and the borrowers, involves a searching and conscientious examination of the following factors:

1. The temptation on the part of borrowers to overestimate the extent of the threatened crop failure by comparing present conditions with those of peak production years rather than with average conditions over a period of years.
2. The natural tendency on the part of borrowers to lean upon liberal bank credit for subsistence in lieu of intensive productive effort, self-denial and rigorous economy.
3. The misuse of credit on the part of borrowers who confuse crop costs with ordinary living expenses, and, under the "dole" system of credit, permit their bank to step into the breach and shoulder their losses and misfortunes,

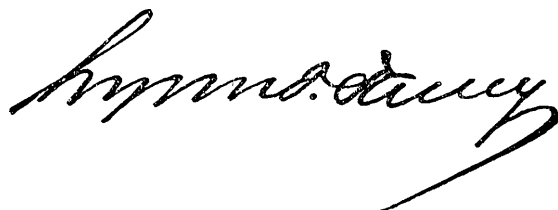
thus shifting to the bank any impairment that may occur in their own capital assets and thus creating ultimately an impairment of the bank's capital funds,—failing to recognize the immutable economic law that sooner or later the community's losses, whether liquidated at the expense of its banks, or not, must be ultimately recouped through a general scaling down of the community's demands and a more intensive program of production.

The resistance offered by borrowers to a suggested temporary program of frugality as a means of relief from financial distress is more pronounced in agricultural sections which have high productive and recuperative powers than is usually the case in other sections where productivity is low and crop failures are not infrequent. And yet the principle here involved remains the same. Where borrowers regard a bank as a sort of commissary, and feel entitled to come to the bank and withdraw cash against loans merely to meet living expenses, it is not likely that any concerted effort will be made in that community to practice the necessary self-denial and economy when crop failures occur, particularly when the productive and recuperative powers of its farms are such as to impose but little necessity for paying heed to the question of repaying borrowed money.

In its final analysis the evil of over-extension of credit as the result of poor crop conditions is the inevitable outgrowth of the failure on the part of the lending bank and its borrowers to realize that a bank's duty is not to supply capital deficiencies, but to maintain its own capital intact; and that its function is not to lend its own funds or resources, but to lend the resources of one part of the community to another part of the community. When a bank finds itself contributing to the community out of its own resources, instead of basing its extension of credit upon the present or prospective resources of the community itself, it is inevitable that at some definite time in the future the credit supply (which is a fixed and measurable thing) will be greatly reduced or exhausted by the undue proportion of available resources tied up in "frozen loans."

While we recognize that credit cannot be administered under any inflexible rule or policy, each application being entitled to treatment on an individual basis, experience has shown that at least one generalization can be safely applied in formulating policies looking to the control of the **volume** of credit extended in the face of unfavorable conditions. If, as banking experience teaches, it is sound banking practice to expand credit judiciously from time to time during a good season, based on a favorable outlook for a large and profitable production, then by the same process of reasoning credit should be judiciously conserved when the situation is reversed and the prospects for production are poor. This is the universal rule and practice in the administration of credit to all other lines of industry and business, and represents a principle that cannot be violated with impunity in the administration of agricultural credit.

Yours very truly,



Governor.