THE COUNTRY BANK AND AGRICULTURE

Address
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American citizenship, including banking, probably never before has faced a time when forces beyond their direct control loomed so large among those that shape their destiny We are on a road whose ending no man can see. Plans made in Moscow or London events that fall in the near East or in Western Europe, may be more decisive than our own plans and decisions in determining the course of our welfare in the months and years ahead. With that prospect, it will be hard to hold your interest in my prosaic discussion of the historical relationship between banks and farm credit, the opportunities that face country banks in the future in that field, and the part city correspondent banks can take in helping their country brothers live up to them. Nevertheless, that is my assignment today, so let's get at it.

My subject today puts me very much on the spot, in the light of A.B.A. country bank activities during the last year. Bill Baily has preached the gospel of banking's responsibility to agriculture in every section of the country. The Agricultural Commission of the A.B.A. with the able assistance of A. G. Brown for many years has provided a bountiful flow of excellent information on banker-farmer relations to bankers all over the country.

These efforts in behalf of A.B.A. are having a telling effect on country bankers, and through country bankers on farmers. The suggestion in A.B.A.'s "Program for Country Banks" in 1944, that banks consider naming an officer to take charge of all matters that pertain to farming and farm finance has resulted in some 1,625 such designations. The fact that there are now upwards of 500 country banks in the United States with outside farm programs directed by agriculturally trained men is in no small way the result of aggressive effort by the A.B.A.'s Agricultural Commission.

A.B.A.'s semi-annual Farm Land Price Bulletins, beyond question, have been an important factor in encouraging the self-restraint that so far has prevented a complete runaway situation in land prices. Land price rises have been greater than we like, but in view of the tremendous upward pressures in the land market, these restraining influences have not been ineffective or in vain.

In order to set our subject in perspective, I believe we can agree that the public conception of banking's relation to agriculture had become badly warped in the inter-war years. Even today many farmers and some farm leaders believe that with the depression bankers lost interest in agriculture, and that the very nature of the banking business makes it ill-adapted to serve the long-run credit needs of farmers.

Some of the banking experiences of the past have been responsible for this type of thinking. It grew out of the heavy lending on inflated property values during World War I and the years that followed. Then with the depression property values collapsed, and bankers became far more cautious in extending new farm credit and in handling loans already on the books.

These experiences, particularly the depression reactions, led many farmers to believe that banks are not adapted to the farm loan business. Even today banking practices in some communities continue to feed the fire of adverse farmer opinion of banking. A month or so ago, a country banker who is located in a strictly rural community told me that he did not have a single farm production loan on his books and he was proud of it. Such banking policies misrepresent the entire banking system, but they are very effective in warping the public's conception of banking's contribution to agriculture. Unfortunately they are more likely to attract public attention than a banking service well done.

The idea that bank deposits shrink in periods of economic stress, making it necessary for banks to call old loans and impossible for them to extend new ones, has been widely spread among farmers and farm leaders by competitive governmental farm loan agencies and others. There is some historical justification for it, and it has received wide acceptance. This condition has been true of individual banks where excessive runs on deposits, coupled with slow loans, non-liquid investments and inability or unwillingness to borrow or rediscount, curtailed operations or forced complete failure of the banks. These excessive runs, however, were abnormal even in times of economic stress. Some developed because the public distrusted the management of the involved institutions. Others were generated by fear and rumor. There were other instances where conditions such as local drouth or business contraction brought deposit levels of individual country banks down to a point that forced curtailment of lending operations. But in practical operation these were individual instances not true of the banking system as a whole. Changes in aggregate deposit levels of all banks are the result rather than the cause of changes in loan and investment volume. Let's take a short look at the record.

Following the low point in deposits of 1933, loans at member banks continued to decrease to 1935. Because of the expansion of government borrowing, however, the aggregate deposit level of member banks rose sharply in the same two-year period. Private lending by member banks was decreasing, but public borrowing was increasing in sufficient volume to raise total deposits. The overall deposit level was not the limiting factor in the extension of credit, and the cash position of member banks was good. The trends of country bank deposits and loans followed a pattern generally similar to that of all member banks, except that deposits in country banks fell considerably more in relation to their loans than was the case for member banks as a whole. Country bank security investments dropped materially in 1932 and 1933, which was contrary to the average trend for member banks.

The numerous runs on banks and the high number of bank failures during the period of June 1930 to June 1933 were reflected in the operations of banks that managed to stay in business. Many responsible bankers adopted rigid collection policies, became cautious about advancing additional money on current loans, and tightened up on new loan applications. This in turn caused farm leaders to ask Congress for help, and you are all familiar with the development of the Production Credit Associations which followed.

In the sense of location, the Production Credit Associations brought government credit service to the front door of every American farm home. But from the farmer's viewpoint, too much of this early effort in the production credit field was confined to refinancing old indebtedness at a time when farming as a whole badly needed an influx of new operating capital. Looking back at the record, we can see that this fact, coupled with slow operating procedures, limited the effectiveness of these government agencies during the period of greatest need. This was true generally notwithstanding conspicious local successes many PCAs achieved. By the time these agencies had become capable of providing a reasonable service to farmers the banking crisis had passed.

PCAs big volume-building year in the non-real estate credit field was between July 1, 1934, and July 1, 1935. In the same period bank deposit levels rose to a point approaching the high levels of the late 'twenties, and country bank deposits moved up with them. But the loan volume at country banks continued to decline while their security holdings rose sharply. Country banks had abundant resources to satisfy the reasonable needs of farmers for operating credit even in PCAs big volume-building year. Their failure to do so was a result of depression experience. In their uncertainty and lack of confidence many banks turned away from sound farm operating loans in their search for liquid security investments. This liquidity supersensitiveness has been costing each one of thousands of country banks thousands of dollars in annual earnings every year since then.

It is interesting to speculate what would have happened if part of the time and expense required to create and activate a complete and competitive duplicate set of lending machinery had been devoted to the study and correction of the bank weaknesses that had been revealed at the time. It can reasonably be contended that banks could have given farmers a better production credit service throughout the depression years than they received from banks and government-sponsored production credit agencies combined.

This glimpse of depression history paints the darker side of the picture, suggesting the uneasiness and heartaches of agriculture and banking under almost unbearable economic pressure. It is only part of the story. Unfortunately, it is the part of the story that has remained most solidly fixed in the public mind. The other side of the story - that of the courage and fortitute of bankers literally with their back to the wall - has been largely obscured by what on the surface appeared to be banking's unwillingness or inability to relieve the suffering which the American farmer helped bring upon himself through overindulgence along with the rest of us in a period of inflated prosperity. Let's take a look at the other side of the record and see to what extent the farmer actually was thrown out of the bank.

The year 1931 is the first year when complete data are available for all types of agricultural loans. In that year, the total farm debt was near an all-time high and the trends that followed give an interesting picture.

The percentage of total bankable farm debt held by banks dropped sharply from 25% in 1931 to 15% in 1935. By 1946, however, banks held 28% of the total which, be it remembered, included farm mortgage debt so largely held by insurance companies and other institutional investors, and the Federal Land Banks. The percentagewise drop from 1931 to 1935 was largely the result of banks shifting away from farm real estate loans. The percentage of other loans (excluding farm real estate debt) held by banks dropped some, but was never below 80% of the total volume outstanding. This estimate does not include loans made by individuals, on which information is not available. The percentage of the total farm real estate debt held by banks, on the other hand, dropped from 10% in 1931 to 7% in 1935. This loss has been regained, however, and on January 1, 1947, commercial banks held 14% of the total.

Of the total farm mortgage debt held by the Farm Credit Administration and commercial banks, 44% was carried by banks in 1931. By 1935, bank holdings had dropped to 16% of the total. In recent years, banks have regained much of this loss, and 40% of the FCA-bank farm mortgage loan total was held by banks on January 1, 1947.

Banks held 97% of the total of ordinary-risk farm production and operating loans on January 1, 1931. Their holdings dropped to 80% in 1935 but had moved up to 86% by 1946. The FCA units making the ordinary-risk production and operating loans to farmers, which in the main were the PCA and their predecessors, held 15% of the total operating and production loans in 1935. By 1946, the percentage held by PCA, which had taken over the lending program that in 1935 was shared by RACC, had dropped to 13% of the total. It is interesting to note here that while PCA has gained in terms of total volume, in terms of its relative position to other lenders it has lost ground slightly since 1935.

Since banks have been most active in the short-term, or operating, farm loan field, let's focus our attention for a moment on that type of loan. Since 1935, banks have never supplied less than 80% of the total sound farm production and operating credit direct to farmers. The balance has been advanced by units of the FCA which make loans to farmers and to farmer cooperatives. These FCA units obtain funds largely through Federal Intermediate Credit Bank discounts. The Federal Intermediate Credit Bank in turn obtains funds through the sale of debentures to the investing public. Banks not only have supplied 80% or more of the farm production credit directly to farmers, but in addition, since December 31, 1934, banks have purchased from 73 to 85% of the Federal Intermediate Credit Bank debenture issues offered for sale. It is evident, therefore, that the banking system has supplied most of the funds with which competitive agencies have made loans to farmers and farmer cooperatives. All things considered, then, has the banking system done such a bad job in farm finance? I think it has done a very commendable job.

The banker's service to agriculture is even more complete from the standpoint of numbers of farmers served. In 1945, the last year for which comparable figures are available, 80% of all production and farm operating loans outstanding on July 1 to banks and PCAs combined were on commercial bank ledgers and only 20% were on the books of the PCAs. Of all farmers who borrowed from banks and PCAs combined in that year, 91% were served by commercial banks and only 9% by PCAs.

The record I have given you is interesting but it has not convinced many influential farm leaders that banks, if they will, can meet the demand for farm credit. The country banking system not only has suffered from the non-progressive attitude of some of its members; it also has suffered badly from the lack of an aggressive information bureau. It should not be impossible to get over to the public and to farmers and their leaders the simple facts that bankers at no time have furnished less than 80% of the total volume of sound farm production credit directly, and that they have furnished indirectly, through the purchase of Federal Intermediate Credit Bank debentures at low rates, 75% or more of the balance. And another thing - while PCA competition undoubtedly has been a factor in reducing interest rates on farm production loans through the last decade, another and much greater factor has been the pressure of a growing volume of investment funds that have forced rates down on government bonds and commercial loans.

But this is all dealing with the past, and we are concerned with the future of banking in the agricultural loan field. We have already seen how much of the sound short-term farm financing done by FCA is simply an indirect distribution of bank funds to farmers. The direct approach to distribution of bank funds, if it is done on an equitable rate basis, can reduce distribution costs, prevent duplication of effort, and bring a higher return to the banking system as a whole than is possible with the indirect approach. In spite of that obvious fact, almost 20% of the volume of sound farm production loans is being served by indirect distribution. Banking has held its own percentagewise in recent years, but a growing total volume of loans has been disbursed to farmers by government agencies whose loanable funds are largely drawn from low-yield bank investments.

At the present time, $388 million of Federal Intermediate Credit Bank debentures are outstanding. Probably 80%, or $306 million, is held by commercial banks. At the present yield of approximately 1.1%, these debentures are providing income to banks on an annual basis of $3.4 million. If banks made this amount of loans directly to farmers and farmer cooperatives with an average yield of 4%, the annual earnings would total $12.3 million. Subtract from this the debenture yield plus a .2 of 1% loss reserve, and a net of $8.3 million would be gained by handling the credits direct. This is sufficient income to put a $10,000 per year outside rural community development program into 830 country banks. That, to me, is a significant possibility.

What, then, is the answer? Should banks stop buying Federal Intermediate Credit Bank debentures? Should an attempt be made to legislate the FCA out of existence? I don't think so. As long as Federal Intermediate Credit Bank debentures are offered for sale, banks might as well buy them. A refusal to buy the debentures would not accomplish anything constructive anyway. Legislatively, I do not think banks can make a very strong case so long as there are predominantly agricultural states where PCAs are furnishing half of the total volume of farm production credit. The only answer I can see is for the banking system to turn what has been a fairly good service to agriculture into a better and more complete service. To do that will require organization and cooperation throughout the banking system.

Any system-wide program of direct banker-farmer relationships logically begins with the country bank. Every country bank which has not already done so should give consideration to planning, organizing and activating a specialized farm service program. Such a program might be tagged by any number of names, but it should have as its objective a complete, constructive and sound banking service to the rural community. Country bank programs of that kind, with which I am familiar, fall generally into two categories. Some are organized as farm loan development activities through a direct loan solicitation program. Others take an indirect approach to loans through a program aimed to help in the sound economic development of the community's natural resources. The latter type of program is gaining in popularity, and many that were organized originally on a straight solicitation basis have drifted toward the complete community service and development approach.

As a good many of you know, I have never been a country banker, but we do have in the Federal Reserve Bank of St. Louis what I think is a strong country bank farm service under an unusually capable head. I should like to outline the eight major steps or elements that we believe are essential to the organization of a successful country bank development program.

1. A survey of the natural resources within the community served by the country bank is probably the most important single consideration in organizing a community development program. This survey should include a careful analysis of the soils, weather, crop and livestock adaptations, markets and the various other advantages and disadvantages the community may have in the overall agricultural picture. The bank's program of activities then should be so organized and laid out as to provide leadership and assistance to local farmers in using the resources they have available for maximum efficiency of production.

2. A survey of the farm income situation within the community served should be made along with the survey of natural resources. Average prices received by local farmers applied to the average production figures give the normal prevailing level of income. Then, again working with the local farm leaders, an estimate should be made of potential farm production increases that might result if a reasonable number of farmers adjusted their operation in line with the farm improvement program sponsored by the bank. Valuing these

potential production increases at the average level of prices gives a reasonably accurate estimate of possible long-run farm income increases in the community. This in turn is a guide to the bank's probable success with the development program.

3. Survey of farm loan potential. Tabulation should be made of the outstanding volume of farm real estate loans, and other loans to farmers, within the community served by the bank. This tabulation should give a breakdown, by lender groups, of the sound loans outstanding, as well as the emergency or subsistence type of credit. This will yield a rough figure showing the amount of debt outstanding, with local resources used about as they are at present. Then an estimate can be made of the total new investment required if the farm improvement program to be sponsored by the bank is adopted on a reasonable number of local farms. Against this can be set the estimate of the new income likely to result, figured in terms of a normal level of prices for the farm products. These calculations will give some idea as to the new loan opportunities arising out of the development program.

4. After the surveys of natural resources, farm income and farm loan potential are completed, I think the bank should consider, on the basis of its findings, whether it is advisable to employ a man with a technical background in agriculture to head up the development program. Some other factors will enter into this consideration. The size of the bank is important. However, I think that many times banks which consider themselves too small would find this a profitable undertaking. Some allowance should be made for the potential growth of the bank under a successful community and business development program. Another factor in determining whether the employment of a specialist is called for is the availability and background of the present officers and employees of the bank. In many instances some man

who is already in the organization might use a part of his time in following through with the development program. I have known some very successful outside activity programs which were carried on by officers of the bank who had no particular training in the technical aspects of agriculture. As a rule, however, I think many banks will find the employment of a "county agent" type of man to head up the farm program worthwhile. Such a man will usually add the very necessary farm touch to the program.

5. Once a bank is interested, the proper choice of activities is vital to the success of its program. Many activities are good for any community, but it is unwise to include more than can reasonably be handled with the facilities available to the bank. Two or three good projects properly handled will give better results than a dozen which do not get out of the paper stage. There are very many activities which might go into such a program, but those selected for a particular bank should be determined by the nature and needs of the community, and the natural inclination of the bank officers responsible for running them. Here a few of the many activities that might be given consideration.

(1) Credit card file
(2) Individual farm loan file
(3) Direct mail
(4) Personal contacts
(5) Physical arrangement of banking quarters
(6) Working with farm leaders
(7) Informal Advisory councils
(8) Meetings
  (a) small meetings
  (b) large annual affairs
(9) Special interests
  (a) soil conservation
  (b) crop improvement
  (c) livestock improvement
  (d) market development, etc.
(10) Youth activities
  (a) 4-H
  (b) FFA
  (c) the In-Between Farmer
(11) Loan rates
(12) Advertising

(13) Personnel training

There are numerous other activities which might be included in a bank's program, but the important thing is to select those that will be most effective in guiding the farmers of the community toward most efficient use of the community's resources.

6. Outline and follow-up of program. In order for a bank's farm program to be most effective, it is important for the banker, at the beginning of each year, to make a definite outline of the activities he wishes to undertake, and to organize a follow-up calendar as a constant reminder of the things he needs to do.

7. Supplementary sources of loan funds. Many banks today are finding it advisable to line up supplementary sources of loan funds. This is particularly true of funds which can be made available to farmers for long-term farm mortgage loans. It also is often helpful to have a source of funds available for sharing large lines of production credit that exceed the legal maximum loan limits of the bank. As a means of meeting local demand for long-term real estate mortgage loans, many banks have entered into working agreements with insurance agencies. This plan enables the local bank to place itself in a good competitive position with the Federal Land Bank and other mortgage companies for the long-term mortgage business of the community, and provides the bank with income otherwise not available. It need not prevent the bank from making real estate loans directly when it desires and when it can meet the terms required by the borrower.

A large volume of sound operating loans to finance large farm operations has gradually found its way into competing government-sponsored farm loan agencies. In many instances, this happened because small banks were unable to carry the credit requirements of some of the larger farms by themselves. Where banks within a rural area are small and liable to call for excess lines of production credit, local bank credit pools may be helpful in sharing the risk on large loans and keeping them within the banking system. Local pools could be helpful in returning many such lines to the banks.

City banks are an important source of supplemental funds which could assist country banks in farm financing. I shall discuss city bank-country bank relationships in some detail a little later so will not dwell on that point now.

8. Additional opportunities. Many banks have found that a specialized farm service department offers opportunity for income in addition to loan earnings. Some country banks handle at least a portion of their trust funds through this department. Other banks have developed farm management services as a part of the farm service department. In this way, they provide on a fee basis direct management for non-resident land owners or local business men who own farms but need technical advice in operating them.

So far, I have talked about farm service programs at the country bank level. But I believe that city banks, while not involved in agriculture in the sense that they make a large number of loans directly to farmers, have a definite stake in banker-farmer relations.

City banks which lack direct farm loan opportunities, nevertheless purchase a high percentage of the Federal Intermediate Credit Bank debentures offered for sale. Again, I want to emphasize that I am not recommending or intimating that banks should discontinue the purchase of these debentures. However, I am raising the question whether it is not possible for city and country banks to work together so that supplemental funds which may at times be needed in a farm community can be advanced by city correspondent banks and channeled to farmers through the country bank outlets.

I recognize the many worth-while services city banks provide their country correspondents. It is no criticism to point out that they provide these services at least partly because of their interest in the country bank balances. Neither is it any secret that some city banks develop rather aggressive programs for obtaining and retaining country bank accounts. It seems reasonable to suggest, therefore, that city banks which are properly desirous of holding maximum country bank balances, should for that reason be anxious to provide services that are of maximum helpfulness to country banks.

A moment ago I mentioned that many country banks are swinging away from direct farm loan solicitation toward an indirect type of business promotion through a constructive community development program. A parallel is the case of the city bank which, observing the experience of these country banks, has shifted, or I should say raised, the level of its approach to the country bank from direct personal solicitation to the indirect approach which helps the country bank meet its day-to-day problems in an increasingly effective way.

I believe, therefore, that a city bank can well afford to consider the employment of traveling representatives who really know farming and farm credit as well as country bank operations, to make some of their calls on country banks. I am thinking of men who are capable of sitting down with the country banker and intelligently discussing with him the day-to-day problems of servicing and developing the rural community. A few city banks in the Eighth District are employing men of this type, and I have observed that country bankers get real inspiration and help from their calls.

So that's the first element which I think should go into the city bank's plans for service to country banks - let them have at least one or two representatives who understand agriculture, farm credit and country bank operations from the ground up. True, men of those qualifications are difficult to obtain. In many instances it may be necessary to employ men who have the agricultural background and who understand farm loan extension and then train them in country bank operations.

I have already suggested a second possible way to improve city bank service to country banks. City banks can stand back of the country bankers with necessary supplemental funds to tide tide them over in periods when they may need help, or to share with them the heavier lines of credit that may exceed legal loan limits. I am fully aware that country banks have received this help from city banks in the past, but a better and more general understanding might greatly broaden this service in the event of future need. A city bank staffed with some men well trained in agriculture would certainly have a better understanding with the country bank on what constitutes sound farm loans. Such a city bank would be in a strong position to extend ready help in case of need.

There may be opportunity for the organization of city bank credit pools especially designed to supplement the farm loan activities of the country banks in their trade area. I can't think of a more heartening development from the viewpoint of farmers and farm leaders than the establishment of such farm credit pools in the metropolitan centers to back the country banks. I know of some cities in which pools of this character are being studied by the local clearing house association with the thought that a farm credit specialist would be placed in charge.

Even if such a pool never made a loan, the confidence and public good will it would generate, in my opinion, would be worth far more than the costs involved. To the farmer, it would be strong evidence that the banking system is willing to handle his credit needs directly without government incentive or guarantee. Competition between the individual banks in the pool and their usual relationships with country banks, need not be impaired.

There is every evidence that the American banking system is in the strongest position of its history to finance the sound credit needs of agriculture, business and industry. Total bank deposits increased from 51 billion on December 31, 1929, to 139 billion on December 31, 1946, while the total loans now carried by banks are well within the 1929 figure. In that year - 1929 - loans made up 72% of the combined investment account of all commercial banks, U. S. Governments 10%, and other securities 18%. On the last date in 1946 for which comparable figures are available for all commercial banks, loans accounted for only 23%, U. S. Governments 71%, and other securities 6%. There is room for loans and food for thought in those figures.

Now in conclusion, let me round up what I have said. The banking system has rendered greater service to agriculture than the public realizes. On the whole, banker-farmer relations have been reasonably good. But at the same time, bankers haven't had a good press. Too large a segment of the public believes that banks are not and cannot become a dependable source of farm credit.

More and more bankers are coming to realize that there is nothing in the past repayment record of farm borrowers that would set them apart as a high-risk group, even counting in the experience of the worst farm depression in history. With proper inter-bank organization and adequate staffing, commercial banks can handle the sound farm production loans and a reasonable portion of the farm mortgage loans without government support and subsidy. If country banks individually will organize good farm service departments, and if city banks will adjust some of their activities a little more toward the country bank's needs and viewpoint, there is no real need to fear further inroads of competitive government-sponsored loan agencies.

Times change, and the business of banking must change, too, to keep up with them. There is little in the future picture to lead one to believe that bank resources will not remain high, and that banks will not continue to be in excellent financial position to serve the sound credit needs of the nation. That includes the farmer, too. To serve him, country bankers, and their city big brothers, too, need to know that end of their job. Reliable farmers are entitled to credit for productive purposes, credit that is tailored to fit their peculiar needs. Banks have the best opportunity to serve that need directly. If they fail to take advantage of it, they will still finance agriculture, but it will be largely through the purchase of low-yield government-supported bonds or debentures.

In this whole discussion, I have not mentioned the facilities of the Federal Reserve System as a source and support for bank liquidity. I am not sure that bankers generally are aware of the changes that have been made in the law to liberalize the loan and discount powers of the Reserve System - changes which place it in strong position to support the commercial banking system if and when help may be needed again.

The local banker controls most of the financial pipelines in his community. He has its deposited funds at his disposal. Two general courses are open to him. He may concentrate his investments in low-risk, low-yield outside securities. This is the easy way. For a time it may provide sufficient income to satisfy the bank's needs. But it will not set the banker up as a useful citizen or the bank as a source of full public service in the community.

On the other hand, he may carefully direct excess local capital first into investments that build and encourage the sound economic development of the community. This means sound loans to farmers and local business to create greater efficiency and rising community income. That is not the easiest way - real success is seldom easy. But it offers the only way for banks to realize their full potential in this or any other field of service. A clear field and easy success are just not going to fall in our laps - we must work for them.

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