Statement of Darryl R. Francis,
President, Federal Reserve Bank of St. Louis
on behalf of the Farm Credit Administration,
before the U.S. House of Representatives
Committee on Agriculture, July 19, 1971,
regarding the Farm Credit Act of 1971

Mr. Chairman, my name is Darryl R. Francis. I am President of the Federal Reserve Bank of St. Louis and am appearing here on behalf of the Farm Credit Administration. For a number of years I had the opportunity of working with the Farm Credit System as secretary of a Production Credit Association, and more recently I served as Chairman of its Advisory Committee on Finance which conducted a study of its future financing requirements. Thus I am vitally interested in portions of this bill, especially the method whereby the System obtains its funds.

Each of the three separate parts of the Farm Credit System — the Federal Land Banks (FLBs), the Federal Intermediate Credit Banks (FICBs), and the Banks for Cooperatives (BCs) -- have in the past raised funds in the nation's capital markets as separate entities. The Federal Land Banks have generally issued long-term obligations while the Federal Intermediate Credit Banks and the Banks for Cooperatives largely limit their debt instruments to nine and six month obligations, respectively.

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

Under existing legislation debt instruments may be issued, with the approval of the Farm Credit Administration, by the individual FLBs and FICBs and by the Central Bank for Cooperatives. Consolidated instruments may be issued by banks in each part of the three-part System. As a practical matter, most debt issues have been of the consolidated type with the proceeds allocated to individual banks on the basis of local fund demands.

Although the practice of issuing consolidated debt instruments, by each bank group, in contrast to individual bank issues, tends to reduce the System's number of marketings, it still markets securities with great frequency. In 1969 the Farm Credit System went to the market 28 times, more frequently than all other Government agencies combined. The total offerings amounted to $11 billion, most of which was used for refunding old debt. New funds raised totaled only $1.2 billion. In the first half of 1970 it went to the market 15 times with total offerings of $6.9 billion and new funds raised of $1.1 billion.

Most of the System's current obligations are of relatively short maturities because of its reluctance to issue longer-term securities at the higher interest rates of recent years. As of June 30, 1970, more than

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

30 per cent of the FLB obligations, 96 per cent of the FICB debentures and all of the BC debentures matured within one year. Of the $12.8 billion capital market debt for the three-part System, over 50 per cent matured within one year. Since mid-1970 some longer term maturities have been issued by each of the three agencies, but the overall maturity schedule is still too short in view of their asset maturities.

The Farm Credit System can maximize its effectiveness in the capital markets by offering a single consolidated instrument rather than separate securities for each of the three bank groups. With one debt instrument for all banks in the System it can reduce its trips to the market, provide funds at more frequent intervals for each bank group, and gain from the greater diversity of risks. A unified security will thus be of mutual benefit to all three groups.

Although it is difficult to compare interest costs among the three Bank groups, evidence indicates that purchasers have no preference for the securities of one group over those of another. For example, on January 20, 1970, the FLBs issued bonds with a 42-month maturity which sold at an 8.45 per cent yield. Three months later, they issued another 42-month bond at a yield of 7.80 per cent. In between the two FLB issues,

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

the FICBs issued a 36-month debenture at a yield of 8.15 per cent. A gradual reduction of rates on Aaa corporate bonds occurred during this period, but the fact that the FICB securities were priced at yields about midway between the two FLB issues indicates little difference in the public's pricing of issues of the two bank groups. In September 1970 the FLBs sold bonds with a 42-month maturity at a yield of 7.30 per cent and the FICBs sold debentures with a 34-month maturity at a yield of 7.32 per cent, a further indication that little difference in quality is recognized between issues of these two bank groups. An issue with a 36-month maturity was sold in October 1970 by the BCs at a yield of 7.3 per cent, about the same rate as similar issues sold by the FLBs and FICBs during this period of relatively stable interest rates.

In the absence of sizable differences in risk, basic statistical knowledge tells us that a unified security for the System will usually be less risky than a security issued by either bank group separately. A unified security in which all banks of the System are jointly and severally liable will probably sell at a lower yield and provide lower cost funds for lending than a security offered by any one bank group. A unified security provides greater diversity in farm credit assets

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

as security for Farm Credit Bank indebtedness. For example, if farm mortgages weaken and the FLBs are unable to meet their share of principal or interest payments, owners of the unified security would still be protected, provided the FICBs and BCs can meet the remaining portion of the FLBs obligation. Such a security provides an automatic mechanism for greater cooperation among the three parts of the System. I suspect that this type of assistance is essential since the inability of one group to meet its obligations would cause the market for securities issued by the other two to weaken.

A unified security would likely result in a better secondary market for Farm Credit System securities as it would be better known than securities of the separate bank groups.

Such a security would involve fewer and more regular market entries. This would result in some efficiencies through lower printing, marketing, and servicing costs.

With a unified security each bank group can prepare for new financing at regularly scheduled offerings and still choose financing terms subject to individual needs and preferences. Each group can still maintain its separate identity in lending operations. Their lending is inherently regional, whereas their borrowing is primarily national and on an impersonal basis.

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

The belief that major efficiencies can be achieved with the use of a single debt instrument for the entire System was uniformly expressed in a recent study by the Advisory Committee on Finance for the System. I am thus pleased to note that the proposed legislation extends the opportunity for the System to issue such obligations. Nevertheless, in view of the long period of separate financing, the great resistance to change from established practices, the preponderance of evidence for more orderly marketing of obligations, and the prospective efficiences of a single offering, I suggest that this means of obtaining capital funds be expressed in the Act as the intent of Congress.

In addition, it is my belief that the Act could be further improved by authorizing the Central Bank for Cooperatives to function as a central bank for the entire System. This move would conform with the marketing of a single security and formalize some of the activities that are already being performed by the Central Bank. For example, its balance sheet for May 1971 shows loans of $50 million to the BCs, $42 million to the FICBs, and $18 million to the FLBs. At the same time it showed borrowings of $16 million from the BCs, $4 million from the FICBs and $1 million from the FLBs.

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

These operations are evidence of the fact that the Central Bank for Cooperatives is in reality a central bank for the three-bank group. It currently receives surplus funds from all banks in the System and makes loans to all banks. Therefore, it should be the agency to receive and dispense funds from the System-wide obligations outlined in this proposal. I thus suggest that its real function be outlined and its ownership and management be changed in this legislation to conform to this broader functional pattern.

In summary, my view of the proposed Farm Credit Act as currently constituted is that the permissible move toward a single debt instrument is a progressive step, that the desirability of raising funds in this manner should be expressed as the intent of Congress, and that the Central Bank for Cooperatives operations should actually be formalized in the legislation to make it a Central Bank owned and operated by the entire Farm Credit System. I would be glad to amplify these views or receive any other questions you may wish to ask.

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