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PROBLEMS, POLICY ISSUES, AND RESEARCH NEEDS IN RURAL FINANCIAL MARKETS: THE VIEW OF RURAL BANKS

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Characteristics of Rural Financial Markets

In attempting to assess the characteristics of the rural financial marketplace to determine whether it is different from other financial markets, one might first take a look at the financial institutions serving our marketplace. The following, while perhaps not all inclusive, offers a fairly complete listing:

1. Banks
2. Thrifts
3. Credit Unions
4. Insurance Companies
5. Finance Companies
6. Brokerage Firms
7. Mutual Funds
8. Cooperatives
9. Agri-business Vendors
10. The Cooperative Farm Credit System
11. Government Agencies:
    a. Commodity Credit Corporation
    b. Farm Home Administration
    c. Small Business Administration

All of these are competing with each other, some rather vigorously, for lendable funds and sound credit risks for loans. The first seven are perhaps common participants in any market, but the last four are more peculiar to the rural marketplace.

Next, we might look at who it is we're attempting to serve in this market. Agriculture is certainly the most prominent user of funds, with grain and livestock producers being habitually short of sufficient capital to fund their operations. The agri-business arena encompasses chemicals, biologics, pharmaceuticals, machinery, seed, grains, transportation, and food processing. Other areas, such as retailing, distribution, construction, communication, municipal government bodies, housing, and medicine exist, just as in the urban marketplace. The consumer, of course, is ubiquitous.

In rural areas, the individual remains the most important net provider of funds, with older people proving to be the more significant suppliers of individual bank deposits. Rural areas have a higher percentage of older people in their population bases and rural states rank highly in their percentage of people over age 65. Iowa, for example, has one of the highest percentages of people over 65 in its population of any of the fifty states.

Challenge of the Rural Market

The uneven application of consumer protection laws and regulations has proved to be rather challenging to banks over the past several years. Usury laws, for example, have tended to impede the flow of credit to individuals and have had a negative effect on consumer lending, housing, small business, agriculture and agri-business. Usury statutes have proved to be most difficult to cope with for those institutions dealing with a preponderance of non-corporate customers in their lending bases, which is the situation that exists in the rural areas. To complicate the matter further, these statutes are not applied even-handedly against banks and government agencies. The same situation exists regarding Regulation Z (truth-in-lending), which affects banks differently than it does production credit associations. And it should be pointed out that the Community Reinvestment Act only applies to depository institutions.

Bank regulation, it might be argued, offers several significant inequities. Interest rate differentials in Regulation Q favor thrifts when often the only private sector lender serving housing in rural areas may be a commercial bank. The uneven application and cost of reserves on deposits continues, although a phase-out period does exist. New non-bank entrants into the marketplace, such as the money market mutual funds, are exempt from both Regulation Q and Regulation D (reserve requirements) and are at liberty to skim funds away from a local market without any obligation such as banks have to reinvest.

Agricultural lending has been especially difficult during the period of huge commodity surpluses that we presently experience in this country, principally in feed grains. Widely fluctuating commodity prices that have been gravitating downward have destabilized farm income and cash flows. Government intervention in the marketplace remains a necessity in order to deal with the surpluses and attempt to provide some semblance of market stability. Government activities in the export markets remain a painful reality. A strong dollar combined with unpredictable and usually late announcements of farm program changes by the United States Department of Agriculture have proved frustrating for producers as well as for all those financial institutions serving rural markets.

There are also displacements being caused by more aggressive activity from non-bank lenders, especially the captive financing companies supporting the manufacturing and sale of farm machinery. A greatly depressed market for farm tractors has existed throughout 1982. Annual retail sales of tractors have dropped from an estimated 140,000 units in recent years to around 80,000 units this year. Captive finance companies serving this area must provide wholesale floor planning for a retail dealer organization and ultimately purchase and hold retail conditional sales contracts in order to facilitate final sale of a product. Credit, which is so often necessary to make the retail sale of these "big ticket" items possible, has been provided at substantially lower-than-market rates as the incentive to move products. This condition, which is also true within the automobile industry, has had a significant effect on what has been a lucrative source of borrowers for banks over the past forty years. The business has been siphoned away, perhaps not by design so much as by prevailing market circumstances.

Difficulties resulting from highly inflated land values are apparent. Farm operators cannot afford to acquire and own land when income from grain and livestock production will not provide for sufficient cash flow to properly amortize mortgage debt. Consequently, we witness a slow but steady increase in tenant operated farms and more absentee landlords. The situation does admittedly result in a major supply of capital for agriculture, as land acquisition by non-operators often brings new and rather large blocks of capital investment into the rural market. The results of this trend, however, are evidenced in bank notes with more and more higher risk credits to tenant operators characterized by: (1) heavy debt to net worth ratios; (2) high use of term debt for equipment purchases; and (3) more dependency on future anticipated income to liquidate debt.

The character of the rural financial marketplace is definitely changing. The rural bank competes increasingly in the national market for its deposit funds and must pay competitive national market rates. Advancing technology has made the brokerage firms, money market funds, insurance companies and others as convenient to the consumer as is his local bank. Geographic remoteness is no longer a significant factor, given today's communications and improved transaction capabilities.

Deregulation will undoubtedly improve the competitive edge for funds of the community bank when combined with the advantages of a brick and mortar presence and FDIC deposit insurance. As a provider of loanable funds, however, community banks experience an increasingly acute disadvantage in that they operate in rather local and confined geographic marketplaces where well balanced economic diversity and opportunity are not always present.

Issues and question facing rural bankers during the remainder of this decade include the following:

1. Will the lack of purchasing power in the farm sector, resulting from a long depressed agricultural economy, have a profound and lasting effect on agri-business during the balance of this decade and produce significant alterations in rural credit markets?
2. Will the deregulation of the deposit gathering function have a profound effect on the structure of rural financial institutions?
3. Will an apparent excess availability of credit in the rural market allow government agencies to continue to play a prominent role in this market, or will their role be assumed by the private sector?
4. Is there a way to handle the current and anticipated grain surplus problems that would be less disruptive of the commodity markets?