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W. C. Coffey, Acting Director

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University Farm, St. Paul, Minnesota

THE USE OF PRODUCTION CREDIT BY FARMERS

Prepared by E. C. Johnson

The term production credit refers to short-term credit used by farmers for the purpose of paying current expenses of operation in the production of crops and livestock. It is a term which has come into general use since 1933 when production credit associations were organized by the Farm Credit Administration to provide "production credit" for farmers. This type of credit should be distinguished from long-term farm mortgage credit which is used primarily to acquire and improve farm real estate. In other words, production credit provides the funds to meet operating costs on the farm while farm mortgage credit provides the funds for purchasing, improving and equipping the farm.

There are certain principles which are fundamental to proper use of production credit and farmers borrowing money for production will find it to their advantage to keep them in mind. A brief discussion of these principles follows.

The first principle is that the borrower should study his farm business and be reasonably certain that the funds borrowed can be used profitably in the production of crops and livestock. Production loans are paid from income from the sale of farm products and unless the enterprise to be financed is likely to produce sufficient income to enable the borrower to pay the loan when due it is unwise to borrow for such enterprise. The farmer who has kept records of his farm business has a distinct advantage in analyzing this problem because his records will show what his average yields have been and the amount of expenses in previous years as well as giving other valuable information. If the farmer is dealing with a credit institution which understands his problems, the analysis of his loan by this institution should be an aid to him in determining whether or not it will be a productive loan. No credit agency performs a service for a farmer by making a loan which he can not be expected to repay. Thus while the applicant for a loan may not realize it at the time, nevertheless it is often true that the credit agency performs a distinct service for him by rejecting an application for a loan which would merely place him in a more difficult financial position. In this connection, it is important to emphasize again that production loans are expected to be paid from current income from the farm and even though a farmer offers ample security, the loan should not be made except in cases of emergency unless the funds can be used productively. In other words, the important consideration is the prospect for income to liquidate the loan. A dairy farmer, as an example, might offer a chattel mortgage on his dairy herd and equipment as security for a loan, but such a loan would not be considered productive and should not be made unless the farmer will have income to pay the loan over a reasonable period of time. From the standpoint of collection by the creditor, the loan may be entirely sound because he could foreclose and take the property which would sell for enough to pay the loan, but in selling this property, the creditor would put the farmer out of business. No

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credit institution operating on a sound basis in the interest of the farmer will make a loan knowing, at the time the loan is closed, that it can be collected only by selling the farmer out.

A second rule to follow in using production credit is to arrange for payment at a time when cash will be available from the sale of farm products. If the loan is for crop production, the note should be drawn to mature approximately at the time when the crop will be marketed. Similarly, if it is a loan to purchase feeder livestock, the loan should be paid at the time the finished animals are sold and the note should be drawn to mature at that time. A plan which is very desirable from the farmer's standpoint is that followed by production credit associations, as well as some other creditors, of permitting payments on a loan in any amount at any time prior to maturity and charging the borrower interest only on the unpaid balance of the loan. Under such an arrangement, the dairy farmer who has income every month may make regular payments, with a minimum amount per month usually agreed upon when the loan is made. Not only is it to the farmer's advantage to make payments when income is available, but it is to the creditor's advantage also by facilitating the collection of loans. The farmer is more likely to pay a note which comes due at the time he has income available than a note, for example, which matures three months after cash has been received from products sold because meanwhile this cash may have been spent for other purposes.

A third principle for the farmer to follow is to obtain the credit at the lowest cost possible. This means that the farmer must acquaint himself with the credit agencies making loans and the costs of obtaining loans from the various agencies. At present, farmers who can give adequate security can obtain production loans at favorable rates.

All farmers of the United States now have access to production credit associations which are farmers' cooperative credit associations organized under the supervision of the Farm Credit Administration. They are not emergency institutions but are set up as permanent cooperative associations to provide short-term credit for farmers, and as such must confine their loans to sound liquid loans. In Minnesota, there are twenty-nine production credit associations. Their initial capital was provided by the Production Credit Corporation of St. Paul which subscribed for the Class A or non-voting stock of the associations. The Class B or voting stock is held by farmer borrowers. When a farmer borrows from his association, he must own Class B stock in an amount equal to $5.00 for each $100 of loan. The farmer can look upon his stock as an investment which can be transferred to other eligible borrowers and which will maintain its value provided his association operates on a sound basis. On August 31, 1935, the average amount of Class A stock outstanding per association was $84,530 and Class B stock outstanding, all held by farmers, $7,260.

Production Credit Associations in Minnesota are showing a steady growth and on August 31, 1935, after about one and one-half years of operation, had a total of $3,690,005 in loans outstanding. Table 1, which is based upon data obtained from the Production Credit Corporation of St. Paul, shows the number and amount of loans outstanding by districts in Minnesota. The rate of interest on loans by production credit associations is five per cent. The borrower also pays an inspection fee which, except on small loans, does not exceed one per cent.

Table 1

Loans Outstanding in Minnesota Production Credit Associations
August 31, 1935

District	Number of production credit associations	Number of loans outstanding		Amount of loans outstanding		Average amount outstanding per loan
		Total	Average per association	Total	Average per association	
Northwestern	4	1,227	307	$509,493	$127,373	$415
Northeastern	3	1,029	343	254,137	84,712	247
Central	9	2,861	318	1,209,891	134,432	423
Southwestern	8	1,985	248	1,124,890	140,611	567
Southeastern	5	1,011	202	591,594	118,319	585
Minnesota	29	8,113	280	3,690,005	127,242	455

Local banks which are very important agencies in providing production credit for farmers have increased their loans in recent months. Table 2 is a classification of loans for 37 banks in southwestern Minnesota, based upon data obtained by the Division of Agricultural Economics in a credit survey during September, 1935. The average amount of loans and discounts per bank was $201,570 of which 76.8, or $154,886, was loans to farmers. Nearly three-fourths of the short term loans to farmers by banks were secured by chattel mortgages. The rate of interest ranged from six to eight per cent.

Table 2

Average Amount of Loans to Farmers Outstanding per Bank in 37 Local Banks in Southwestern Minnesota Classified According to Security
September, 1935

Security	Average amount per bank	Per cent of total loans to farmers
First real estate mortgage	$17,218	11.1%
Personal note only	30,406	19.6
Chattel mortgage on livestock equipment or crops	100,137	64.7
Other security	7,125	4.6
Total loans to farmers	154,886	100.0

In addition to loans from production credit associations and banks, farmers also obtain a large amount of production credit from merchants, individuals and private credit corporations. Generally speaking, credit furnished by merchants, particularly for installment purchases, is expensive and farmers who can borrow from other sources will usually find it advantageous to do so and pay cash for goods purchased.

The fourth rule which is fundamental to proper use of production credit and which borrowers should follow is to pay notes promptly when due if it is at all possible to do so. Every farmer will find it to his advantage to establish and maintain a good credit rating. This he can do by meeting his obligations promptly or, if impossible to do so, by arranging in advance for their renewal. The income of the farmer is likely to vary greatly from year to year due to variations in yields of crops and fluctuations in prices of farm products. In the years when income is favorable, the farmer will find it to his advantage to make every effort possible to pay debts, for by doing so he places himself in a position to obtain credit necessary to tide him over the unfavorable years which are bound to come.

A credit system which operates on a sound basis will insist on payment of loans when income is favorable and should be able to carry solvent farmers through periods of emergency.

MINNESOTA FARM PRICES FOR SEPTEMBER 1935

Prepared by W. C. Waite and W. B. Garver

The index number of Minnesota farm prices for the month of September 1935 was 73.6. When the average of farm prices of the three Septembers 1924-25-26 is represented by 100, the indexes for September of each year from 1924 to date are as follows:

September 1924	93.6	September 1930	84.4
" 1925	102.7	" 1931	55.0
" 1926	102.8	" 1932	41.1
" 1927	99.5	" 1933	57.5
" 1928	101.0	" 1934	81.5*
" 1929	109.7	" 1935	73.6*

*Preliminary

The price index of 73.6 for the past month is the net result of increases and decreases in the prices of farm products in September 1935 over the average of September 1924-25-26 weighted according to their relative importance.

Average Farm Prices Used in Computing the Minnesota Farm Price Index, September 15, 1935, with Comparisons*

	Sept.15, 1935	Aug.15, 1935	Sept.15, 1934	Av. Sept. 1924-25 26	% Sept.15, 1935 is of Aug. 15, 1935	% Sept.15, 1935 is of Sept. 15, 1934	% Sept. 15, 1935 is of Sept. 15, 1924-25-26
Wheat	$.98	$.99	$1.06	$1.24	99	93	79
Corn	.66	.67	.70	.91	99	94	73
Oats	.21	.22	.49	.36	95	43	58
Barley	.37	.32	.91	.56	116	41	66
Rye	.32	.31	.75	.77	103	42	42
Flax	1.39	1.37	1.78	2.19	101	78	63
Potatoes	.34	.42	.50	.84	81	68	40
Hogs	10.60	10.70	6.10	10.59	99	174	100
Cattle	7.10	6.70	4.50	6.12	106	158	116
Calves	8.10	7.20	5.40	9.17	114	152	89
Lambs-sheep	7.56	6.92	5.10	10.92	109	148	69
Chickens	.143	.125	.113	.179	114	127	80
Eggs	.24	.21	.19	.29	115	129	82
Butterfat	.26	.24	.26	.41	108	100	63
Hay	5.48	6.32	14.22	12.00	87	39	46
Milk	1.52	1.51	1.53	2.21	101	99	69

*Except for milk, these are the average prices for Minnesota as reported by the United States Department of Agriculture.

Indexes and Ratios of Minnesota Agriculture*

	Sept. 1935	Aug. 1935	Sept. 1934	Av. Sept. 1924-26
U.S. farm price index	78.1	75.2	74.5	100.0
Minnesota farm price index	73.6	70.8	81.5	100.0
U.S. purchasing power of farm products	85.6	88.6	89.9	100.0
Minnesota purchasing power of farm products	89.5	83.4	98.3	100.0
U.S. hog-corn ratio	13.2	12.6	7.8	11.7
Minnesota hog-corn ratio	16.1	16.0	8.7	12.9
Minnesota egg-grain ratio	19.1	16.4	12.1	17.5
Minnesota butterfat-farm-grain ratio	31.9	30.9	16.1	35.4

*Explanations of the computation of these data are given in Farm Business Notes No. 144.