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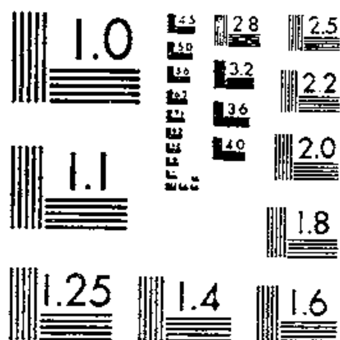

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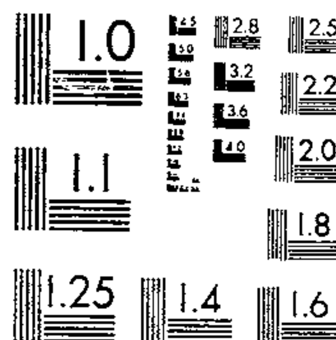

MICROCOPY RESOLUTION TEST CHART
NATIONAL BUREAU OF STANDARDS-1963-A

TECHNICAL BULLETIN No. 322 SEPTEMBER, 1932

UNITED STATES DEPARTMENT OF AGRICULTURE
WASHINGTON, D. C.

AGRICULTURAL CREDIT CORPORATIONS AFFILIATED WITH COTTON COOPERATIVE MARKETING ASSOCIATIONS[1]

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INTRODUCTION

The precipitous drop in cotton prices from 40 cents a pound in June, 1920, to 11 cents in March, 1921, gave an impetus to the

[1] This study was planned and initiated in cooperation with the Division of Cooperative Marketing, which was later transferred to the Federal Farm Board. Two of the case studies made as part of this general study have been mimeographed as preliminary reports. They are The Texas Cotton Growers Finance Corporation, and An Analysis of The South Carolina Agricultural Loan Association. Acknowledgment of assistance is made to the officers of the corporations who contributed liberally of their time; to numerous persons who read the manuscript critically, and particularly to Fred L. Garlock, who contributed much to the analysis. Credit is due Mrs. Martha Marceron Adams and Mrs. Pauline Luxford for the preparation of the statistical material.

organization of large-scale cooperative cotton-marketing associations. The years immediately following saw a rapid growth in the movement, in most cases through state-wide organizations. Five associations were organized in time to market cotton of the 1921 crop, 10 in time to market cotton of the 1922 crop, 14 in time for the 1923 crop, and 16 in time for the 1927 crop. Table 1 gives by years the number of these cooperative associations, the number of bales of cotton delivered, and the proportion of the total United States crop which they constituted.

TABLE 1.—*Number of associations, cotton received, and percentage of total production handled cooperatively by large-scale cotton cooperative associations, 1921–22 to 1930–31*

[Data from Federal Farm Board]

Season	Large-scale associations	Cotton marketed cooperatively	Percentage of total production	Season	Large-scale associations	Cotton marketed cooperatively	Percentage of total production
	Number	*Bales*			*Number*	*Bales*	
1921–22	5	352,226	4.4	1926–27	15	1,208,663	6.7
1922–23	10	764,928	7.8	1927–28	16	823,105	6.4
1923–24	14	928,562	9.2	1928–29	16	1,164,330	8.1
1924–25	15	1,090,507	8.0	1929–30	15	1,435,175	9.0
1925–26	15	1,472,580	9.1	1930–31	12	2,348,970	[1] 17.1

[1] Subject to revision.

In the years before 1930 these associations handled less than 10 per cent of the crop produced. One of the causes, or what is claimed to have been a cause, for this poor showing, has been the difficulty of obtaining delivery of mortgaged cotton. The cotton crop is usually produced with borrowed funds, the loans being secured by mortgages on the crop. Thus a grower, even though a member of a cooperative marketing association, is often powerless to deliver his cotton because his creditor has a lien on the crop.

There are several reasons why creditors have frequently refused to permit growers to market their cotton through cooperative associations. First, the amount of funds obtained immediately from the associations in many cases has been too small to repay the loan.[2] Until the establishment of the Federal Farm Board in 1929 the customary advance on cotton in the seasonal pool was about 60 or 65 per cent of the market value. As borrowers were often unable to pay their debts out of this advance, creditors, to protect themselves from loss on unpaid balances, preferred that the cotton be sold outright at current market prices. It is said that another reason why creditors have often refused permission to market through the cooperative associations is that they have wanted the profits from the sale of the cotton for themselves, their business associates, or their friends. It has also been alleged that many creditors have refused

[2] The associations have attempted to sell the cotton only as demand arises throughout the year; consequently they can not pay the farmer at the time he delivers it. They borrow money on the cotton as security and advance that to the member in part payment. Further advances have been made to members only as sales warranted after the debt on the cotton has been paid. In later years, however, several optional plans have been offered whereby the members have been able to obtain full or almost full liquidation at the time of delivery.

to permit growers to deliver their cotton because of active opposition to the program of the cooperative associations by groups of business men. Undoubtedly, in some cases, the reported objections by creditors have been an excuse rather than a reason for not living up to the membership contract, but it is probably true that the system of growing crops on borrowed money and under mortgage has been a hindrance to the development of cooperative marketing of cotton.

The passage of the agricultural credits act in 1923 gave promise of a solution to this problem as well as to the problem of marketing credit. The chartering of the Federal intermediate credit banks by that act started a new chapter in the history of the cotton cooperative marketing associations. These banks were authorized to make direct loans to farmers' cooperative marketing associations secured by warehouse receipts for staple agricultural commodities. The act thus provided the cotton cooperatives with practically an unlimited source of commodity credit, a need which they had felt severely. Previous to the organization of the Federal intermediate credit banks, the associations were obliged to obtain such credit from local banks or from large banks in distant cities. Generally speaking, the local banks were unable to provide sufficient credit, and large banks in distant cities were often not interested, for they were unfamiliar with the cooperative form of organization and unacquainted with the particular organizations applying for credit. Hence, the formation of the Federal intermediate credit banks with authority to make commodity loans to cooperatives was welcomed by the cotton associations.

More pertinent to the problem of obtaining delivery of cotton, was the authority granted these banks to discount farmers' notes for financial institutions, particularly agricultural credit corporations. The cotton cooperatives saw in this discount privilege granted to agricultural credit corporations, a possible solution for their difficulties in obtaining delivery of mortgaged cotton. By organizing subsidiary or affiliated corporations they could finance the production of those members who would otherwise be unable to deliver their cotton on account of objections by creditors. It was felt that the very existence of a subsidiary financing corporation would provide the members with enough bargaining power to obtain permission from their creditors to market their cotton through the cooperative.

But the benefits of an affiliated finance corporation were not limited to getting delivery of mortgaged cotton of farmers. This new adjunct would make available to all members a financing service in addition to the marketing service. Members already in the organization would be benefited, and new members would be attracted.

The value of this new service to farmers of the Cotton Belt who were members of the associations is best appreciated in the light of the credit situation there. The region is sometimes termed a capital-deficit area. The available wealth and savings of the people are insufficient to meet the credit needs. Outside funds are required to finance industry, particularly during the peak season. Thus credit is in general more difficult to obtain than is true in regions that possess a surplus of loanable funds. Moreover, the cost of credit to farmers in cotton States has been relatively high. (Table 2.) Credit

in some areas of the region is often difficult to obtain, even at high rates. Crop failures and low prices for cotton have cut deeply into the lending resources of banks and merchants. Bank failures since 1920 have been exceedingly numerous, resulting in a loss to many farmers of their only available source of cash credit at the same time that their current working and reserve funds were lost. Hence, the new financing service for members was in many cases a real attraction, particularly since the cost of funds from agricultural credit corporations was often less than the cost from other sources.

TABLE 2.—*Cost on a per annum basis of credit in Southern States*

State	Cash credit			Merchant credit		
	All	Owner	Tenant	All	Owner	Tenant
	Per cent	*Per cent*	*Per cent*	*Per cent*	*Per cent*	*Per cent*
North Carolina [1]	7.7	7.7	7.9	25.5	27.7	20.0
South Carolina [1]	9.6	8.8	10.5	31.6	32.6	30.4
Georgia [1]	11.5	8.6	16.0	26.3	27.1	26.0
Arkansas:						
Craighead County [1]	8.7	8.7	8.7	17.7	13.5	18.9
Altheimer district	8.8	7.7	10.0		20.0	41.5
Rison district	10.0	10.0			18.0	20.0
Louisiana	8.1			16.6		
Oklahoma [1]	11.4	11.0	11.6	34.8	18.4	38.5
Texas	9.4			27.0		

NOTE.—Data are averages obtained from eight separate studies made by the sampling method between 1927 and 1930. Reports of these studies were published by the agricultural experiment stations of the various States, the Bureau of Agricultural Economics cooperating in the preparation of all except those in Louisiana and Texas. North Carolina Bul. No. 270, South Carolina Bul. No. 282, Georgia Bul. No. 153, Arkansas Bul. No. 233, Arkansas Bul. No. 228, Louisiana Bul. No. 208, Oklahoma Bul. No. 198, and Texas Bul. No. 351.

[1] Averages weighted according to the size of the loans.

The cotton cooperative associations were quick to take advantage of the Federal intermediate credit system. By 1924, 4 credit corporations had been formed and were lending money to members of the affiliated associations. In 1925, 4 more were in operation. In 1926 another 4 were added to the list; in 1929, 1; in 1930, 2, and in 1931, 2. Thus a total of 17 credit corporations have been organized although not all have continued operation or maintained their affiliation with the marketing associations. Their location and their significance as represented by the volume of loans made up to and including 1930, are shown in Figure 1.

Agricultural credit corporations affiliated with cotton cooperative marketing associations classified as to first years of operation, 1924–1931, are as follows:

1924

North Carolina Agricultural Credit Corporation, Raleigh, N. C.
Staple Cotton Discount Corporation, Greenwood, Miss.
Agricultural Credit Corporation, Oklahoma City, Okla.
Texas Cotton Growers' Finance Corporation, Dallas, Tex.

1925

Growers' Finance Co., Atlanta, Ga.
Alabama Farm Bureau Credit Corporation, Montgomery, Ala.
South Carolina Agricultural Loan Association, Columbia, S. C.
Cotton Association Credit Corporation, Little Rock, Ark.

1926

Tennessee Agricultural Credit Corporation, Memphis, Tenn.
Louisiana Agricultural Credit Corporation, Shreveport, La.
Mississippi Farm Bureau Agricultural Credit Corporation, Jackson, Miss.
Southwestern Cotton Credit Corporation, Phoenix, Ariz.

1929

California Cotton Growers' Finance Co., Delano, Calif.

1930

Alabama Cotton Credit Co., Montgomery, Ala.
Cotton Credit Corporation, Memphis, Tenn.

1931

Growers Agricultural Credit Corporation, Raleigh, N. C.
Production Credit Corporation, El Paso, Tex.

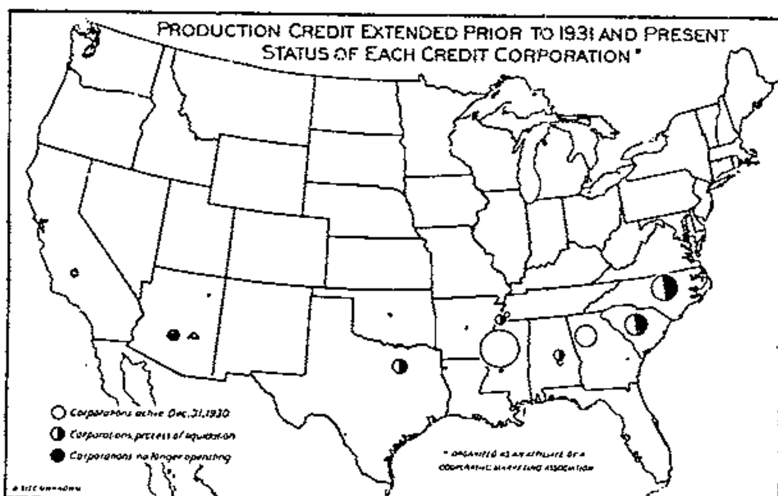

Figure 1.—Agricultural credit corporations organized as affiliates of cotton cooperative marketing associations prior to 1931. The size of the circles indicates relatively the volume of production credit extended by each prior to 1931

CHARACTERISTICS OF ORGANIZATION

The agricultural credit corporations that have been formed by the cotton cooperative marketing associations as a rule have been organized under the general corporation laws of the States in which they operated and have been subject to the regulations that cover ordinary commercial corporations rather than to those covering banking institutions. One of the corporations was organized under the statutes governing cooperative associations in the State.

CAPITAL-STOCK FEATURES

The capital structures have usually been simple, the customary practice being to issue only one type of stock. In two cases, a few shares of special no-par-value stock have been issued in addition to the regular stock. In these cases, the no-par-value stock had the

entire voting power and was held by the directors and the cooperative marketing organizations that promoted the corporation. Prior to 1930, preferred stock had been issued by only one corporation; it was not preferred as to dividend and assets as is customary with preferred stock but was rather a special stock planned for ownership by banks.

The par value of stock issued by these corporations has varied. In several cases it has been $10 per share, and in others it has been $25 and $100. Low par-value figures have generally been used in order to make it possible for individuals to own small amounts of the stock.

THE STOCKHOLDERS

In general, the ownership of stock has not been limited to any particular group. The corporations have been glad to sell their stock to anyone who would buy it, and no need for restrictions has been felt. One exception is that of a corporation which limited the ownership to members of the cooperative marketing association who were actually cotton growers.

Stockholders may be classed in three general groups. First, the cotton associations themselves. In three cases the cooperative association has owned all the stock except a few shares held by the directors of the corporation. In nine cases, the cooperative association has owned only a part of the stock of the corporation, but that part has been either the voting stock or a sufficient amount of the common stock to control the election of directors. Hence, 12 of the corporations have been distinct subsidiaries of the cotton cooperatives. In the case of four others, the cooperative associations have owned no stock whatsoever in the affiliated credit corporations.

The second group has been that of the incorporators, consisting usually of officers and directors of the cotton association and officers and directors of the corporation. The amount of stock held by this group has often been only nominal.

The third and most important group of stockholders has been the borrowers. Most of the corporations have required their borrowers to purchase stock, in an amount usually equal to 10 per cent of the loan. This provision has enabled the corporations to increase their capital as their volume of business grew. In one corporation, the stockholders were all members of the cotton association. They invested no cash, but the cotton association advanced the funds and charged the amount subscribed by each member against his equity in the association's reserves.

CONTROL AND MANAGEMENT

In all corporations except one the privilege of voting has been allotted among the holders of voting stock in proportion to the number of shares held. In the case of the exception each member has had one vote regardless of the number of shares owned. The managements of the cotton associations as a rule have experienced no difficulty in maintaining control as little interest is taken by stockholders in their voting rights. Furthermore, the stock has been

widely scattered in small lots, and the managements have found that by asking for proxies they can readily control the affairs of the corporations.

As a rule, the directors of the finance corporations have consisted of all or a part of the directors of the cotton associations. They have not usually taken an active part but have left most of the decisions to the officials.

Officers of a credit corporation have generally been a president, vice president, secretary, and treasurer, elected by the directors from their own group, and a manager who was appointed. Active affairs of the corporation have usually been handled by the manager under some supervision from the president, who almost invariably has been the president also of the cotton association.

In only one corporation have specific restrictions been placed on loans for farming purposes to directors and officers. In that instance, the directors and officers are permitted to obtain loans only if they pledge marketable securities or other investments in excess of the amount of the loan.

RELATIONSHIP BETWEEN THE CORPORATIONS AND THE COTTON ASSOCIATIONS

The relationship between the cotton associations and the credit corporations, although not always that of parent and subsidiary, has in most cases been very close. The two organizations have usually been under the same management, working toward one goal. They have often been located in the same building and sometimes in the same office. In some instances, the employees of the association have done the work of the corporation also, and in one case the association has paid all the expenses. In all cases loans have been collected through the association out of amounts due the members for their cotton. The two organizations have in some cases loaned money to one another, the association lending to the corporation in the spring when loans are being rapidly advanced and borrowing in the fall the inactive capital funds of the corporation.

Regardless of how close the relationship and regardless of the fact that to outsiders and to members they have appeared as one and the same organization, they have been in the eyes of the law two separate and distinct entities, and neither has been responsible for the debts of the other.

A rather loose relationship existed in the case of the first North Carolina and the South Carolina corporations. The cotton associations owned no stock of the finance corporations, and commercial banks as well as the associations were instrumental in organizing the corporations. The credit corporations served not only members of the State cotton cooperative associations, but also members of the Tri-State Tobacco Association and, in later years, farmers who were members of no association. In both of these cases, the only relationship that existed between the management of the corporation and the cotton association was that some directors of the cotton association were also on the board of directors of the corporation. The two organizations were not located in the same offices, nor was the administrative work done by the same staff. At present both credit corporations are entirely independent of the cotton associations.

TYPES OF LOANS

Most of the agricultural credit corporations that have been mentioned were organized by the cotton cooperative associations primarily for making production loans on cotton. A number of other kinds of loans have been made also, some of them to aid the cotton cooperative associations as such and others chiefly to aid the members of the associations.

PRODUCTION CREDIT LOANS

Advances for production include by far the largest part of the loans made by these corporations and constitute the primary feature with which this study deals.

A crop-production loan is one made to finance the growing of a particular crop, or all of the crops, of a particular farm. It is usually secured by a lien on the crops and often with such additional security as is available. Loans made by these credit corporations have been largely for growing cotton, but some corporations have made loans for the production of tobacco and peanuts, and even for dairy products. Loans, although made on the basis of cash crops, are used for the production of feed and food crops as well. Funds obtained by rediscounting loans with the Federal intermediate credit banks must by law be used only for agricultural purposes. Furthermore, it is the custom to require that the money loaned be put into the production of a crop. Production purposes are generally construed to include purchase of fertilizer, seed, and feed, advances to tenants for living expenses, and a small advance for the necessary living expenses of the borrower. In some cases, borrowers are permitted to use the funds for the purchase of livestock and implements and for drainage work.

The distinction between production loans and other types of loans is not always clear and varies in individual cases. Loans for some of the purposes enumerated above border closely on consumption loans, whereas in other cases they border on loans for capital investment.

Production loans are subject to all the risks of the crop, including those arising from inclement weather, floods, boll-weevil and other insect infestation, and shortage of labor. In addition, they are subject to the risk of a drop in the price of the products grown. There is also the personal risk; the borrower may not know how to manage his farm, he may not be industrious, or worst of all, he may even be dishonest.

HARVEST LOANS

Two of the corporations have been making additional loans to the borrowers at picking time if needed; these are called harvest loans. One of them has made such loans in the form of an additional advance. The other has permitted the borrower to keep a part of the early proceeds from the liquidation of his crop instead of requiring that all such proceeds be applied immediately to the repayment of the production loan. In one case, the corporation at the time of this study was limiting the loans of such character to 15 per cent of the estimated value of the crop. The other corporation customarily allowed $15 a bale on all cotton delivered, although the amounts varied from $5 to $25.

LOANS TO OBTAIN DELIVERY AT PICKING TIME

Several of the corporations have been making loans at picking time to association members who could not deliver their cotton because of objections by creditors holding mortgages on the crop. The Arkansas corporation handled only this type of loan. The corporation paid off the loan and took over the mortgage.

As these loans are of short duration, and as a number of the hazards of the crop have been successfully passed, the risk is not so great as on production loans. Nevertheless, the few weeks or months during which the loan is outstanding cover a critical period. The borrower may sell all or part of the cotton and thus jeopardize the security of the loan; the cotton is open so that wet weather may seriously reduce its quality and value. Then, too, the cost of making these short loans is little if any less than the cost of loans for longer periods, and the small amount of interest collected on the loan during its short term hardly justifies the risk and expense involved. To the cotton association, however, the delivery of a bale of cotton obtained by such a loan is just as satisfactory as the delivery of a bale obtained through a production loan.

SUPPLEMENTARY LOANS ON POOLED COTTON

Loans on delivered cotton, supplementary to the advances made by the associations, have been made by two of the corporations. The advance of 60 to 65 per cent of the value of the cotton when placed in the seasonal pools was as much as the cooperative associations could borrow from the banks by pledging the cotton as collateral. It was felt that if this advance could be increased, membership in the cooperative would become more attractive. As a matter of fact, some members needed an amount larger than 65 per cent of the value of the crop to enable them to pay off the loan on the crop and to obtain a release of the mortgages in order that the cotton could be delivered to the association.

Officers of these associations felt that a larger advance could be made safely; they used the affiliated credit corporations for this purpose. These supplementary loans were secured by assignments against the proceeds from the equities of borrowers in cotton that had been delivered to the association.

The amount of the loans was determined by various factors. Needs of the borrower, his character, and his reputation, were considered. Although the element of character might be largely disregarded in the association's advance of 65 per cent of the value of the cotton, that element could not well be disregarded when increasing the advance to perhaps 80 per cent through a supplementary loan.

Other factors determining the size of the loans were the quality of the applicant's cotton, and the price of cotton. The association's original advance was made uniformly on all cotton but before the supplementary loans were made, the cotton was classed as to grade and staple. If the grade and staple of the applicant's cotton were above the average, the excess value of such cotton was reflected in the size of the supplementary loan granted. If there had been a marked change in the price of cotton between the time of the

original advance and the time of application for a supplemental loan, that fact would affect the size of the loan.

The experience with loans of this type was not so bad as might be expected. Falling prices during the marketing seasons for 1926 and 1928 cotton made it necessary in many cases to call for payment of the note or pledging of additional collateral. Losses, however, were small, and in the case of one of the corporations they were taken over by the cooperative marketing association.

Loans of this type, like those made to obtain delivery at picking time, have not been rediscountable with the Federal intermediate credit banks. Usually they were made out of the capital funds of the corporation or out of funds obtained by loans from the cotton associations or other sources. The granting of supplementary loans on pooled cotton to the cooperatives by the Federal Farm Board during 1929 and 1930 have made such loans by the affiliated credit corporations unnecessary.

MISCELLANEOUS TYPES OF LOANS

Two of the credit corporations have made some loans on dairy cattle. The usual amount of the loans has been 50 per cent of the value of the stock. Loans have been made only if there has been a satisfactory market for the products. These loans have been repaid in monthly installments and hence have involved more work, particularly if the borrower has been lax about making payments promptly each month. Although the margin of interest that the corporation has earned on such loans has been one-half of 1 per cent larger than on crop loans, the business has not been profitable because of the heavy expense. At the time these data were being gathered it did not appear likely that the practice of making dairy-cattle loans would be greatly extended as the credit corporations were operated by the cotton-marketing associations and had little interest in dairying. Extremely low prices for cotton since that time, however, have led to a strong movement for reduction in cotton acreage, and the cotton associations may possibly approve or even encourage loans for the production of commodities other than cotton.

A few miscellaneous loans have been made by the various corporations, such as loans on eggs in storage, loans to fertilizer companies as advances for delivery of fertilizer, and loans to other credit corporations. Even farmers' notes for purchase of windmills have been rediscounted. Most of these miscellaneous loans have been made at the instigation of the parent association. In these cases the association has used the finance corporation as a convenient lending medium and would have made good any losses.

Loans have been made by a few corporations to employees and officers of the corporation and the cotton associations. Such loans are not generally looked upon with favor unless they represent advances for traveling expenses or other business purposes.

In several corporations, surplus funds have been loaned during the fall and winter to the cotton association. It has been the usual practice to charge interest at the rate which the association was paying elsewhere. Some corporations have made the loan on open ac-

count; others have taken warehouse receipts from the association on the same basis as a bank would lend it money.

OPERATING PRACTICES

The first credit corporations that were formed had little precedent or experience to follow in determining their practices and policies. The Federal intermediate credit banks also were new organizations without experience. As a result of years of experience, however, a fairly satisfactory set of practices is now established. Considerable uniformity is to be found among the corporations, owing partly to the influence of the Federal intermediate credit banks, and partly to conferences between the officers of the credit corporations in various States.

PROCEDURE IN MAKING LOANS

The first step in the procedure of making a loan is to have the farmer make application in writing. The application gives information relative to the financial condition, farming ability, and probable income of the applicant. A form used by one of the corporations for this purpose is shown in Figure 2. The borrower is required also to present a financial statement showing his assets, liabilities, and net worth. He must show both actual and contingent liabilities. Some corporations require a list of tenants and the basis on which they are employed; some require a list of livestock, with a description of each animal; others require a list of all the chattels.

As they operate usually over a whole State it is necessary for the corporations to have some way of making local contacts. The association field men are used by some corporations, whereas others employ field men of their own. These field men accept applications, and often examine the farms of the applicants and the security for the loans. Some corporations have appointed persons in various cities and county seats to take applications for loans. They do not as a rule examine the farms and property of the applicants, but they are often familiar with the applicant's credit standing.

One organization, the Texas Cotton Growers Finance Corporation, has found it desirable in some counties to use local loan committees, often composed of the county agent, one or two farmers of good standing who are members of the cotton association, and other persons of good repute. These committees accept applications, pass upon loans, and recommend or refuse them. They are advisory only and assume no financial responsibility. They work for practically no compensation except the satisfaction of rendering a semipublic service. To be successful a committee of this sort must be made up of individuals of a very high type.

When the application is finally received at the corporation's office, it is examined and passed upon by the manager. (In some organizations, the manager's work is simplified by first having a clerk examine the papers as to completeness and accuracy, and in some instances there is a loan committee to which the manager presents his findings and which ultimately approves or disapproves the loan.) Almost invariably, if the loan is approved by the corporation, it must be approved by the Federal intermediate credit bank for rediscount before it can be granted, for the corporations have little money

APPLICATION FOR LOAN

(IN DUPLICATE)

TO.. ....
(Name of bank) (Address) (Date)

1. Application is hereby made for a loan for $......................, the proceeds of which are to be used for making my crop.

2. I own the following amount of stock in the Staple Cotton Discount Corporation, $..............................

3. Yields of Cotton for last five years on land in cultivation this year are as follows:

	Crops for Last 5 Years	Acres in Cotton	Number Bales Ginned	Value of Cotton
4.	19...... CROP	A.	B/C.	$
5.	19...... CROP	A.	B/C.	$
6.	19...... CROP	A.	B/C.	$
7.	19...... CROP	A.	B/C.	$
8.	19...... CROP	A.	B/C.	$
9.	TOTAL			$ ....

10. Average value per acre $......................

11. 50 per cent of average for the 5 years. (Divide total by 10) $......................

12. 75 per cent of smallest crop $......................

13. Do you own all lands in cultivation this year: ....

14. If not, amount of rent to be waived: ....

15. Acres in Cultivation this year:......................Acres in cotton:......................Acres in feedstuffs:......................

16. Number families Last Year......................This Year:......................Average work hands to family:......................

17. Labor employed as follows: No. Cash renters......................No. cotton renters:......................No. Sharehands:......................

18. Number white tenants:......................How many families do you supply:..

19. Will you control the sale of all cotton covered by this application: ....

20. How many head of work stock:......................Mules:...................... Horses: ....

21. Where did you obtain funds last season for making crop:..

22. How much balance, if any, do you owe $......................

23. I hereby agree, in the event the notes securing this loan are discounted by the Staple Cotton Discount Corporation, that:

(a) Said corporation shall deduct one (1) per cent of the total loan and said amount shall be placed in the Reserve for Losses account of the said corporation.

(b) All cotton produced on the property covered by this application will be promptly ginned and delivered to Staple Cotton Cooperative Association.

(c) Reports with reference to the condition of the crop and the harvesting thereof will be furnished said corporation when requested.

(Signed) ....

(Address) ....

I, an officer of this bank, do hereby certify that I am familiar with the affairs of the farmer or other individual whose name appears on this application for a loan and that, to the best of my knowledge, the above is a true statement; and that I have authority by order of the Board of Directors to discount the paper covering the above application.

(Bank) ....

(Officer) ....

FIGURE 2.—Sample form of application used by one of the corporations included in this study

of their own to lend. Hence, the papers are next sent to the Federal intermediate credit bank.

If the loan is approved by the bank the following forms are prepared in the office of the corporation: A note; a mortgage, lien, or bill of sale on the crop, livestock, and implements; an assignment in favor of the corporation of cotton to be delivered to the association; and papers for any other security required. These papers are sent to the applicant for signature and for recording of the liens. The applicant is also required to obtain, from some county officer or an attorney, a statement showing that no prior liens are recorded against the crop or chattels. Upon return of these papers to the corporation office, they are examined carefully; if correct, they are sent to the Federal intermediate credit bank. In most cases, the corporations find it necessary to await the remittance from that bank before advancing the funds to the borrower.

This long and detailed procedure, involving the approval of the loan by a local representative or loan committee, then by the manager of the corporation, then by the executive committee, and finally by the Federal intermediate credit bank, requires much time. The papers usually must be sent through the mails to the corporation's office, from there to the Federal intermediate credit bank, back to the corporation, then to the borrower for signature and recording, then back again to the corporation, which forwards them to the bank. The remittance is then sent from the bank to the corporation, and the corporation sends it to the farmer. Thus, eight trips through the mail are required before the farmer gets his money.

A week is about the shortest period possible for these operations under the most favorable circumstances; from two to three weeks is customary. It is little wonder that one of the chief complaints against the system is the time and delay involved. In fact, the length of time required to get loans from the agricultural credit corporations, together with the uncertainty of the farmer during that period as to his source of funds for the year, is one of the reasons why more farmers have not borrowed from the corporations.

The Federal Intermediate Credit Bank of Columbia attempts to meet this difficulty by requiring that applications sent to the bank include all papers completed and ready for rediscount with the mortgages or liens recorded. To require the applicant to record a mortgage some weeks before he knows whether he will be able to get the loan may be a strict requirement, but the practice helps him to get his money sooner than would otherwise be possible, and if the loan is refused the mortgage is released.

CONTROL AND FOLLOW-UP OF USE OF FUNDS

To be assured that the funds loaned will be put into the crop, most corporations advance some of their loans in installments. One organization uses the monthly installment method almost exclusively. This practice prevents the borrower from spending all or an undue proportion of the money in the early part of the season. Such indiscretion is likely to necessitate the granting of a supplementary loan to save the crop, with the result that the total of the loans on the crop is larger than was originally considered justifiable. Another advantage of advancing the funds in installments rather

than in a lump sum is that the money is not withdrawn in advance from the Federal intermediate credit bank, or it is kept in a large city bank where there is little danger of bank failure. Loss of funds by the borrower through failure of a local bank often means a carry-over or a loss for the corporation because the borrower has to have another loan if he is to make his crop.

Credit corporations find it necessary to watch closely the growth of the borrower's crop, because that crop frequently is the most important part of the security. As many as two or three visits during the summer are sometimes made to observe the progress of the growing crop, the character of the cultivation, and the danger from boll-weevil damage. If the crop is in danger of being lost, it is often necessary to grant an additional loan so that the farmer can hire extra labor or perhaps put more money into control of the weevil by poisoning. Sometimes if part of the crop is lost, the subsequent monthly advances are reduced. Some associations operating over wide territories have found it impossible to visit isolated farms frequently and have resorted to sending interim letters to the isolated borrowers asking about the climatic conditions, the condition of the crop, and the prospects for yield.

COLLECTION OF LOANS

Loans are not customarily collected in cash, but are retired by having the borrower deliver his cotton to the marketing association. The original advance and the following distributions on that cotton are then paid by the association to the finance corporation instead of to the farmer until the loan is completely paid off. Consequently, it is very important that the field staff be active during the picking season, and in some cases extra field men are added. Field men visit the borrower at this time, estimate the size of the crop, and make the borrower understand that he is expected to deliver all of the crop in payment for the loan. If the field man estimates the approximate yield, any unreliable borrower is more hesitant to sell a part of his crop for fear he will be found out. The very fact that the corporation field men are actively watching the crop at harvest time results in a much better collection of the loans.

LOAN REQUIREMENTS

In order to make safe loans it is necessary that certain requirements and standards be set. It is also necessary that those standards be rigorously adhered to. The stated requirements for loans by these various corporations have often been similar, but the extent to which they have been followed out in practice has differed. The results of differing practices are, to some extent, reflected in the present financial standing of these companies.

CONSIDERATIONS IN PASSING UPON LOANS

The first consideration in passing upon a loan is the character of the applicant. If an individual takes advantage of every opportunity to avoid paying a debt, it is considered best to refuse his application without further consideration. Even though the loan be well secured and the papers carefully drawn, a loan to such an

individual is a source of trouble and expense. A problem just as difficult is to exclude those applicants who, although they will not absolutely attempt to avoid payment, will not consider the debt a binding personal obligation and will let the corporation shift for itself if the security becomes impaired or exhausted. Other personal characteristics such as industry, resourcefulness, and general capability are also considered.

Since the loan is for the purpose of making a crop, the probable yield and value of that crop limit its size. The applicant's knowledge of farming and his ability to produce a crop must be weighed along with the probable prices of the products, so as to determine the probable income. To eliminate the uncertainty of the income for the year, some corporations almost invariably recommend diversification of crops, and all corporations require the production of feed crops. They are more inclined to look with more favor on the applications of those farmers who have sufficient feed of their own to take care of the livestock through the growing season. Of course safe margins must be demanded between the probable income from the crop and the amount of the loan.

The borrower's equity in his farm and his net worth are important considerations. For instance, an applicant showing substantial net worth would be granted a larger loan on a given expected income than would an applicant with less wealth. Of late years, owing to the depressed condition of cotton prices and of agriculture in general, there has been a tendency to limit the loans to amounts that could be paid by liquidating the assets of the borrower. Some believe that this practice is the only safe basis on which to lend.

Most of the corporations make loans to tenants who own the livestock and equipment on the farm they rent. Some corporations make such loans only if the landlord endorses the paper. In other cases the landlord is expected to sign a waiver of the rent; in one State he signs a waiver of all other debts and advances except rent. None of the corporations make loans to share croppers.

REJECTIONS

No information is available for the group as a whole as to the number and amount of rejections. Many loans are rejected by field men and other representatives before a written application is ever prepared. Statements by representatives of one corporation indicate that as many as 9 out of 10 persons who asked for loans were refused in 1930. This is probably much higher than a normal ratio of rejections to applications and greatly exceeds the ratio after formal written application is made. Rejections of formal applications by the Texas Cotton Growers Finance Corporation averaged 40 per cent of the number received over a period of four years.[3]

LIMITS TO SIZE OF LOANS

Various limits and standards have been set by the corporations as to the size of loans they will grant. Fifteen dollars an acre on cotton has been a common figure, but with low prices for cotton the

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[3] See the following report: ROWE, W. H. THE TEXAS COTTON GROWERS FINANCE CORPORATION. A PRELIMINARY REPORT. U. S. Dept. Agr., Bur. Agr. Econ. [Rpt., 38 p. 1931. [Mimeographed.]

basis was lower in 1931. The following standards have been used at various times by some of the corporations:

Customary amounts (to be modified if conditions warrant): (1) $15 per acre on cotton; (2) $150 per plow[4] on cotton; and (3) $40 per acre on tobacco.

Maximum limits: (1) 50 per cent of average income for the last five years or 75 per cent of smallest income for any one year, whichever is the smaller. This basis is adjusted for changes in acreage and is reduced in years when prospects of cotton prices are poor. (2) On land yielding one bale per acre, $25 per acre. (3) On land yielding one-fourth bale per acre, $5 per acre. (4) An amount not to exceed a conservative estimate of the value of livestock and chattels. (5) Twenty per cent of the unimpaired capital and surplus of the corporation.

SECURITY FOR LOANS

Whenever a loan is made, a first mortgage, deed of trust, or bill of sale is taken on all the crops. This gives the corporation first claim on the income produced by the funds loaned although it is customary to permit the borrower to sell the cottonseed to meet the extra expenses of the picking season. In the case of carry-over loans, if the corporation does not finance the new crop, it does not as a rule get the mortgage, for the new mortgage is given to the party who finances the new crop.

A first lien is also required on the livestock and implements of the borrower. In some sections where the livestock and implements owned by the borrower often consist of little more than a mule, a plow, and a cultivator per tenant, the actual value of this security is not high. In the fall the mule may sell for $25 or $30, while the implements will probably sell for very little. If the loan per plow has been $150, a foreclosure of this mortgage will not usually bring enough to complete the payment of the loan. Moreover, foreclosure of the mortgage would put the farmer out of business and in most cases destroy all chances of collecting the unpaid balance. It is the view of the officers of one of the Federal intermediate credit banks that the mortgage on livestock and equipment has a value quite aside from its foreclosure value. The existence of this mortgage prevents the borrower who deserts his crop from selling or taking the livestock and equipment with him. Thus the corporation, which stands to benefit by every cent salvaged out of the crop, can employ labor to carry the crop to completion, for the work stock and tools are still at hand.

In other sections the livestock and implements represent a larger part of the wealth of the borrowers and are more important as security. One of the corporations, for instance, has limited its loans to a conservative estimate of the value of livestock and implements. Sample data of borrowers, picked from the records of five corporations, indicate average ratios between the size of loans and the value of the livestock and implements as follows: 1.92, 0.38, 1.14, 1.20, and 1.34. Strange as it may seem, the corporations with the highest and

[4] A man, his family, and a mule.

lowest ratios had had the best collection records at the time the data for this study were obtained, although both have suffered from the effects of low cotton prices and drought since that time.

Mortgages or deeds of trust are often taken on the land, but these are most often second or third liens. If a borrower is heavily involved, the corporation usually considers it desirable to fortify its position by a land mortgage as well as a mortgage on crop and chattels; this prevents other creditors from getting in ahead. If a borrower fails to pay his loan in any year, it is a common practice to require that he give a mortgage on the land if he has any equity in it. Samples taken for two of the corporations over various periods indicate that 40 and 60 per cent, respectively, of the current loans were secured by land mortgages. With the lower prices of cotton during recent years the practice of demanding mortgages on the land is more prevalent.

Most of the corporations require the borrower to pledge the stock of the corporation, which he is obliged to purchase, as security for the loan. From the point of view of the Federal intermediate credit bank, the practice is unnecessary for, since the corporation indorses the borrower's note, the bank has recourse to it and should the corporation fail so that it could not pay the debt itself, its stock would be worthless as security. Pledging the stock with the corporation, however, has distinct advantages to both the corporation and its stockholders. Borrowers who would not otherwise pay their loans in full, will sometimes do so if their stock is pledged so that they may have the stock free to sell or redeem.

A serious injustice might be done if the stock were not pledged. Borrowers who do not pay their loans and who by such actions might cause the failure of a corporation would be entitled to share in the liquidation of the remaining assets on the same basis as other stockholders. Hence it seems very desirable from the standpoint of the corporation and its stockholders to require a pledge of the capital stock owned by the borrower, even though the Federal intermediate credit bank does not insist upon it. Some agricultural credit corporations not included in this study have a provision recited on the stock certificate that the stock will be considered security for any debt of the stockholder to the corporation.

Other security is taken if the borrower has it to offer. Sometimes bonds, stocks, or other investments may be pledged; sometimes mortgages on town or city property are given. Often the borrower is required to assign life-insurance policies. The reserves of an insurance policy represented by its cash-in value make excellent security, and the policy is particularly valuable as security if there is more than the average probability that the borrower will not live throughout the season.

The borrower is expected to assign to the corporation his equity in all cotton he may deliver to the association out of the crop to be financed. This assignment gives the cooperative marketing association the authority to pay to the finance corporation the original advance on the cotton and any subsequent distributions until the loan is satisfied. If in the spring, when the farmer applies for a loan, he has any equity in cotton held by the association from the preceding

season, he may be required to make an assignment of that to the finance corporation also.

TERM OF THE LOANS

The terms of the loans vary. Until an amendment was made to the agricultural credits act in 1930, loans could not be rediscounted for periods shorter than six months. Some corporations make most of their loans for a definite term such as nine months. Others fix a customary date for maturity of notes, such as December 31. A common practice is to have the note mature at picking time. Thus the note matures and payment is demanded when the borrower has cotton or funds to pay the note. Furthermore, in case the cotton is sold rather than shipped to the association, the legal action for nonpayment of the note is easier to substantiate than is action for disposal of the security.

Although the term of the loan may be from 6 months to a year the usual period during which the loans, other than carry-over, are outstanding is seldom more than 6 to 8 months. An average taken of the length of all loans made in a season by one of the corporations indicated that it was 6½ months from date of first advance in the spring to date of final payment in the fall. The average annual earning period for the loans of four corporations has been 7 months or less. (See tabulation on p. 42.)

LOAN EXPERIENCE

Experiences of these corporations in their lending activities have varied widely. Some of these corporations have been large organizations playing an important part in the financing of the cotton crop; others have been mere experiments. Some have dealt in large loans; others in small ones. Some have collected practically all loans each season, thus making each year's operations a separate enterprise; others since the first year have been burdened with uncollectible loans. Some have been operating continuously since they were organized; others have operated for a year or two and then passed out of existence.

VOLUME OF LOANS

The volume of business done by these agricultural credit corporations is important, for in a sense it measures the amount of service rendered. Table 3 shows the maximum amount of loans outstanding each year for 11 corporations. This list includes all corporations organized prior to 1931 by cotton cooperative associations, except one which operated in Arizona, a small one which operated for two years in Oklahoma, and one in Arkansas which did not make production loans.

TABLE 3.—*Total production loans (new and carried over) for 11 corporations, 1924–1930*

Corporation	1924	1925	1926	1927	1928	1929	1930	Total
	Dollars	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*
A [1]		99, 703	1, 539, 301	636, 669	760, 836	1, 089, 348	992, 880	5, 118, 737
B	512, 927	616, 926	1, 593, 475	1, 338, 354	2, 140, 544	3, 060, 811	5, 520, 490	14, 783, 527
C			194, 231	495, 444	523, 691	734, 420	668, 372	2, 016, 167
D		37, 978	132, 083	204, 704	275, 005	395, 364	[1] 471, 000	1, 516, 134
E		1, 380, 000	2, 160, 000	1, 421, 000	1, 110, 000	620, 000	350, 000	7, 041, 000
F [1]	1, 130, 000	2, 100, 000	2, 600, 000	965, 000	695, 000	500, 000	425, 000	8, 415, 000
G			27, 000	76, 678	350, 873	840, 830	(2)	1, 295, 381
H [1]				35, 875	50, 000	75, 000	(2)	160, 875
I						10, 580	55, 385	65, 965
J			48, 000	75, 000	(2)	(2)	(2)	123, 000
K							270, 000	270, 000
Total	1, 642, 927	4, 234, 607	8, 294, 090	5, 218, 724	5, 905, 349	7, 326, 362	8, 753, 127	41, 405, 786

[1] Estimated. [2] Either liquidated or not operating.

The volume of business varied greatly among the corporations, the smallest yearly volume for any one being about $10,000 and the largest being about $5,500,000. Loans reached a peak of $8,-000,000 in 1926 and then declined. Of late years the volume of loans has increased again, reaching about $8,700,000 in 1930, but $5,500,000 of this was loaned by one organization. In the seven years since the first two corporations were organized in 1924, these corporations have loaned about $41,000,000.

Whereas Table 3 shows total loans, carry-over loans included, Table 4 shows only the amount of new loans made each year. In one or two cases the carry-over loans of a corporation represented more than half of all loans for the year. Furthermore, in 1927 the new loans for all corporations were only 72 per cent of the total loans. This was the result of a rapid expansion of activities in 1926, followed by lower prices for cotton and inability to liquidate the loans. The relationship between the new loans and total loans for all corporations is shown also in Figure 3.

TABLE 4.—*New production loans made by 11 corporations, 1924–1930*

Corporation	1924	1925	1926	1927	1928	1929	1930	Total
	Dollars	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*
A		99, 703	1, 539, 301	586, 621	670, 472	813, 736	[1] 820, 238	4, 530, 071
B	512, 927	606, 077	1, 591, 604	1, 183, 282	2, 062, 412	3, 027, 200	5, 498, 664	14, 482, 806
C			194, 231	461, 866	495, 997	691, 505	299, 417	2, 143, 016
D		37, 978	128, 382	218, 092	316, 212	367, 775	288, 020	1, 356, 459
E [2]		1, 380, 000	1, 877, 000	468, 000	738, 000	129, 000	0	4, 592, 000
F [2]	1, 130, 000	1, 650, 000	2, 400, 000	700, 000	400, 000	400, 000	(3)	6, 680, 000
G			27, 000	68, 985	344, 940	731, 735	(4)	1, 172, 660
H [2]				35, 875	42, 000	72, 500	(4)	150, 375
I						10, 580	55, 385	65, 965
J [2]			48, 000	75, 000				123, 000
K [2]							270, 000	270, 000
Total	1, 642, 927	3, 774, 358	7, 805, 518	3, 797, 701	5, 070, 033	6, 244, 091	7, 231, 724	35, 560, 352
Percentage of total loans	*Per cent* 100. 0	*Per cent* 89. 1	*Per cent* 94. 1	*Per cent* 72. 4	*Per cent* 85. 8	*Per cent* 85. 2	*Per cent* [5] 80. 8	*Per cent* 85. 9

[1] To Apr. 25. [2] Estimated. [3] Unknown. [4] Not operating. [5] Corporation F not used in calculation.

Services rendered by these corporations should be measured in terms of the number of loans made as well as the amount loaned. Data are available only for five corporations and only for the new loans of those. Table 5 shows the number of new loans made, by years, for the first five corporations listed in Table 4. One of the most significant features in the table is the progressive growth of number of loans by three of the corporations, whereas the other two

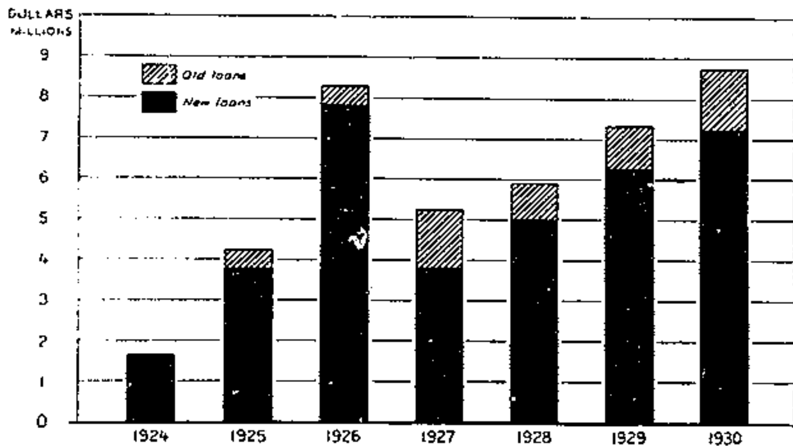

FIGURE 3.—TOTAL AND NEW PRODUCTION LOANS OF AGRICULTURAL CREDIT CORPORATIONS ORGANIZED BY COTTON COOPERATIVE MARKETING ASSOCIATIONS

Total loans rose rapidly within three years to more than $8,000,000 in 1926, but declined sharply the following year. Since 1927 there has been a gradual increase until loans exceeded $8,000,000 again in 1930. Since 1926 the proportion of the loans which are new has been smaller.

made a large number of loans in 1926 but had to retrench thereafter. In 1926 over 4,000 persons were provided loans by these five corporations.

TABLE 5.—*Number of new production loans made by five corporations, 1924–1929*

Corporation	1924	1925	1926	1927	1928	1929	Total
	Number	*Number*	*Number*	*Number*	*Number*	*Number*	*Number*
A		(1)	1,898	570	571	619	3,658
B	56	55	109	112	152	180	664
C			183	335	360	372	1,250
D		28	80	116	144	168	536
E		1,383	2,109	688	904	302	5,386
Total	56	1,466	4,379	1,821	2,131	1,641	11,494

[1] Data not available.

Two of the corporations have made supplementary loans on pooled cotton to members of the affiliated cotton cooperative marketing associations. To make this type of loan was the purpose for which the Texas Cotton Growers Finance Corporation was organized in 1924; such loans constituted its only lending activity until 1926. At present, this business is of secondary importance, having been replaced by the production credit business. Table 6 gives the loans of this type for two corporations. The year 1925 witnessed

the largest volume of such loans, the total that year being about $700,000.

TABLE 6.—*Supplementary loans on pooled cotton, made by two agricultural credit corporations, 1924–1929*

Year	Corporation A	Corporation C	Total	Year	Corporation A	Corporation C	Total
	Dollars	*Dollars*	*Dollars*		*Dollars*	*Dollars*	*Dollars*
1924		606,223	606,223	1927	42,300	478,099	520,399
1925	153,500	548,014	701,514	1928	123,000	125,940	2[illegible],940
1926	37,500	60,954	98,454	1929	47,500	16,915	64,415

Loans of other types have been made by several of the corporations, but the amounts have been neither large nor particularly significant.

SIZE OF LOANS

The size of the loans made by an organization is significant. It is indicative of the type of business that the corporation handles and of the general character of the borrowers whom the corporation serves. It is important also from the standpoint of profitable operation, for the interest earned on loans is directly proportional to the size, yet the cost of making and servicing loans bears little relation to the size and is usually about the same for small loans as large ones. It is not known on which class, if any, there is the greater chance of loss, but it is obvious that failure to collect a large loan would be more likely to weaken or wreck a corporation than would the failure to collect a small loan.

In describing the size of loans made by these agricultural credit corporations, two measures have been used, the average and the median. As the average fails to represent the usual size of loans because it is unduly affected by a few large ones, the median is used here also. The median loan is that one with regard to which half of the loans are larger and half are smaller. Table 7 shows the average and median size of loans for five corporations. Since the size of loans of one of the corporations is far in excess of any of the others, it is segregated from the rest.

TABLE 7.—*Average and median size of loans for five corporations, 1924–1930*

Corporation	1924		1925		1926		1927	
	Average	Median	Average	Median	Average	Median	Average	Median
	Dollars	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*
A					811	400	1,029	400
C					1,061	500	1,370	465
D			1,356	800	1,005	700	1,880	971
E			828	500	890	500	680	379
Average			830		876		870	
B	9,104	5,800	10,949	7,400	14,679	10,000	11,144	6,000
Average			1,218		1,213		1,226	

TABLE 7.—*Average and median size of loans for five corporations, 1924–1930*—Continued

Corporation	1928		1929		1930		Total	
	Average	Median	Average	Median	Average	Median	Average	Median
	Dollars	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*
A	1,174	500	1,315	643	1,250	650	1,027	
C	1,378	500	1,850	650			1,475	
D	2,190	1,000	2,189	1,040	1,880	700	1,986	
E	816	434	905	330			776	
Average	1,095		1,127				965	[1] 404
B	13,176	8,000	16,515	8,750			13,457	
Average	1,887		2,270				1,531	[1] 533

[1] Approximate.

The median size of loans is much smaller than the average. This is due to the effect on the average of a relatively few very large loans. Median figures for loans are not readily available for all corporations by years or for all years by corporations. The median sizes of the loans made during all years for the groups of five corporations are estimated from frequency distributions shown in Table 8. The calculated medians are much smaller than the final averages.

TABLE 8.—*Size of production loans made by five agricultural credit corporations* [1]

Size group	Number of loans			Amount loaned		
	Number	Per cent of total	Cumulative percentage	Amount	Per cent of total	Cumulative percentage
		Per cent	*Per cent*	*Dollars*	*Per cent*	*Per cent*
Under $100	73	0.5	0.5	4,371		
$100-$249	2,983	20.4	20.9	463,023	2.1	2.1
$250-$499	4,041	27.6	48.5	1,355,443	6.0	8.1
$500-$999	3,492	23.8	72.3	2,253,905	10.1	18.2
$1,000-$1,999	1,987	13.5	85.8	2,521,812	11.2	29.4
$2,000-$4,999	1,200	8.2	94.0	3,442,599	15.4	44.8
$5,000-$9,999	464	3.2	97.2	2,983,220	13.3	58.1
$10,000-$19,999	252	1.7	98.9	3,270,237	14.6	72.7
$20,000 and over	163	1.1	100.0	6,122,908	27.3	100.0
Total	14,655	100.0		[2] 22,443,237	100.0	

[1] Data cover the whole period from the date of organization of each to time each study was made.
[2] This total includes $18,710 not classified because a page was missing from the records.

To facilitate the study of size, the loans are grouped into frequency distributions. A distribution of the loans for five corporations covering the whole period of their operation is found in both Figure 4 and Table 8. The size group with the largest number of loans is that from $250 to $499, whereas the group with the largest amount loaned is that of $20,000 and over. The large amount loaned in the last group is attributable mainly to one corporation which makes loans of much larger size than the others. If data of this corporation were excluded from the analysis the largest group according to the amount loaned would be the one from $2,000 to $4,999.

An analysis of loans of $20,000 and over made by the five corporations grouped together is shown in Table 9.

TABLE 9.—*Distribution by size groups of the loans of $20,000 and over made by five corporations* [1]

Size group	Number	Amount	Size group	Number	Amount
		Dollars			*Dollars*
$20,000-$29,999	67	1,573,502	$80,000-$89,999		
$30,000-$39,999	43	1,427,633	$90,000-$99,999	1	90,000
$40,000-$49,999	19	803,700	$100,000-$149,999	5	566,000
$50,000-$59,999	19	994,631	$150,000-$199,999	1	154,000
$60,000-$69,999	6	368,442			
$70,000-$79,999	2	145,000	Total	163	6,122,908

[1] Data cover the whole period from the date of organization of each to the time each study was made.

The wide divergence in size of loans immediately attracts attention. Whereas the great majority of the loans cluster around the $500 mark, a number of them are more than 200 times that size. The question arises to what extent are the corporations dependent

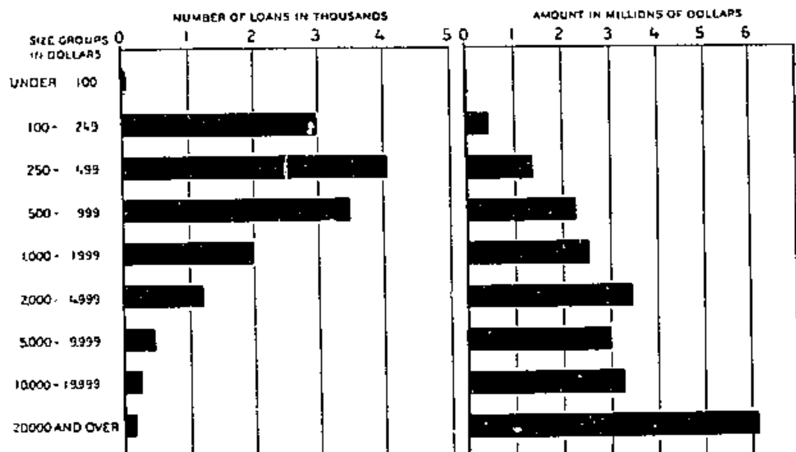

FIGURE 4.—SIZE OF PRODUCTION LOANS MADE BY FIVE AGRICULTURAL CREDIT CORPORATIONS

The largest number of loans is to be found in the group from $250 to $499; the largest volume of loans is in the group of $20,000 and over. Although very few loans in excess of $20,000 were made, the volume of business provided by such loans represented a substantial part of the total. (Data cover the whole period from the organization of each corporation to the date when each study was made.)

on the income from the large loans to support their main program of making smaller loans? It also raises the question how far is the corporation endangered by making loans of such size?

CARRY-OVER

It is virtually impossible to collect all loans each year. Disaster resulting from flood, hail, drought, excessive rain, or boll-weevil infestation almost invariably claim part or all of the crop of some borrowers. Unfortunately, a few borrowers will usually sell some of their cotton and deliver an insufficient amount for payment on

their debt. Even though all cotton is delivered, low prices in some years will mean that at least a few loans will remain partly unpaid.

The extent to which a corporation can collect its loans each year depends upon certain factors within the control of the management and certain factors not within its control. Those within its control consist of the selection of credit risks, the relative size of the loans, the supervision of the growing of the crops, the activities of the field force of both the corporation and the association in getting the cotton delivered, and the success of the management of the cooperative association in selling at good prices. Factors not within their control consist of the general condition of the crop, which is very largely a result of weather conditions, and the general level of cotton prices. Wide variations in the experience of the different corporations have been due to factors both within and outside the control of the management.

The term "carry-over," frequently is used loosely. It may be interpreted to mean the amount of a season's loans unpaid when lending activities for the next season are begun or it may mean the amount of a season's loans that must be paid out of income from the crops of some subsequent season. For most farmers there is but little difference, but for the farmer who is a member of a cotton cooperative there is considerable difference. Until the Federal Farm Board made provision for supplementary loans, association members ordinarily received only about two-thirds of the value of their cotton at the time of delivery. Some cooperative associations were able to pay additional amounts throughout the marketing season and to make a final settlement the following summer. Other associations were unable to make final settlements at the end of each marketing year. Many borrowers, although not able to pay their debt out of the original advance of two-thirds of the value of their product were able partly or entirely to liquidate the balance out of their equity in cotton held by the cooperative association. Thus the amount of loans outstanding when lending operations were renewed each spring would be inflated because the equities of borrowers in pooled cotton had not been liquidated.

Data relative to the carry-over by the five corporations studied are not uniform and satisfactory, principally because of lack of classification of loan accounts. Records of some corporations contain one account only for all loans and discounts; loans of all types including production credit, supplementary advances on pooled cotton, harvest loans, and other loans for current and all past years are combined in one account. Furthermore, few of the corporations segregate their production loans into separate accounts for each season's business. If an account had been kept for each type of loan for each lending season the carry-over at any date from each year's loans would be readily available.

The best figures available with a uniform date for the five corporations are the loan-account balances outstanding at the close of each calendar year. These are shown in the top half of Table 10 and are subject to the following modifications if interpreted as carry-over: (1) Figures for corporation A include many supplementary loans on pooled cotton made in the fall of the year and thus are much in excess of the carry-over of production loans; in fact in some

years they are in excess of the total production loans. (2) Collections between the end of the calendar year and the beginning of the new lending season are often very large. (3) Little except the initial advance on the borrower's cotton has been used to reduce the loans by December 31, the remaining equity in the borrower's cotton being available for further reduction of the loans only at a later date.

TABLE 10.—*Carry-over of production loans of five agricultural credit corporations, 1924–1929*

BALANCE OUTSTANDING DECEMBER 31

Year	Corporation A	Corporation B	Corporation C	Corporation D	Corporation E	Total	Ratio of carry-over to new loans made in same year
	Dollars	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Per cent*
1924		19,175				19,175	3.7
1925	298,829	4,040		14,485	283,248	600,602	28.3
1926	550,584	269,258	[1]	58,706	953,573	1,832,121	35.7
1927	204,112	89,137	38,229	61,155	372,013	765,546	20.2
1928	393,210	83,443	59,915	159,654	491,028	1,187,250	27.7
1929	323,224	123,678	199,333	225,448	367,119	1,238,802	24.6
Total	1,769,059	588,731	297,477	519,448	2,467,881	5,643,496	
Ratio of carry-over to new loans made in same years	*Per cent* 47.7	*Per cent* 6.6	*Per cent* 18.0	*Per cent* 48.6	*Per cent* 53.7		28.2

BALANCE OUTSTANDING THE FOLLOWING SUMMER

Year	Corporation A	Corporation B	Corporation C	Corporation D	Corporation E	Total	Ratio of carry-over to new loans made in same year
	Dollars	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Per cent*
1924		0					
1925	16,000	0		14,000	225,000	255,000	12.0
1926	175,000	2,196	33,577	50,000	850,000	1,110,773	20.8
1927	75,000	56,388	19,188	14,057	325,000	489,633	10.8
1928	275,000	653	27,869	71,737	437,000	812,259	19.0
1929	175,000	21,827	91,598	70,537	335,000	693,962	13.8
Total	716,000	81,064	172,232	220,331	2,172,000	3,301,627	
Ratio of carry-over to new loans made in same years	*Per cent* 19.3	*Per cent* 0.9	*Per cent* 9.3	*Per cent* 20.6	*Per cent* 47.3		16.6

[1] Unknown.

The lower half of Table 10 consists of actual amounts still outstanding in the following summer for corporations B and C and estimates of loans carried over to the following summer for corporations A, D, and E. These estimates were made by the managers of the corporations and are probably accurate. The average amount of loans carried over to the following summer ranged from 0.9 of 1 per cent of the total loans made in one corporation to 47.3 per cent for another. The corporation with the average carry-over of 47.3 per cent is at present in the process of liquidation.

LOSSES

It has been impossible to obtain comparative data relative to losses. All corporations have carry-over loans. Some have written off part of that carry-over as loss even though they felt certain that the amounts would later be collected. Others have continued to show as carry-over, loans which they knew they could not collect.

At the time that detailed studies were made of five corporations the following conditions appeared to obtain: Corporation 1 had no losses and anticipated none. Corporation 2 had taken a loss of $300 which it hoped to recover. Corporation 3 had written off no losses, but the management realized that large losses would finally have to be taken on some accounts. Corporation 4 had written off all losses, totaling $39,510. Corporation 5 had losses estimated by the Federal intermediate credit bank to be $236,838.

For the last two corporations mentioned above, the losses for all years prior to the date of this study represented 1.4 and 5.2 per cent, respectively, of the amounts originally loaned.

REDISCOUNT RELATIONS WITH THE FEDERAL INTERMEDIATE CREDIT BANKS

To obtain the rediscount privilege, an agricultural credit corporation must make application to the Federal intermediate credit bank of its district. Upon application to the bank an examination of the corporation is made by the officials or a representative of the bank. This examination covers the territory to be served, the legal and financial set-up of the corporation, the amount and source of capital, the character of the management, the relationship with affiliated organizations, and the proposed operations of the corporation.

LINES OF CREDIT AND EXCESS-COLLATERAL REQUIREMENTS

The bank each year determines the line of credit it will extend to the corporation. Under the provisions of the agricultural credits act of 1923, which created the banks, the maximum line of credit possible for any corporation is an amount which, added to the other liabilities of the corporation, equals ten times the paid-in and unimpaired capital and surplus. During the early years of the system, lines of credit approximately as large as that were granted. But experience showed a ratio of 10 to 1 to be too large. In some cases the lines of credit were sharply reduced to as low as 4 to 1 on the unimpaired capital. In other cases the reduction was made much more slowly. At present crop-financing corporations are usually granted lines of credit from two to six times their paid-in and unimpaired capital and surplus.

The ratio for each corporation depends chiefly on the character of the management and the quality of the paper offered to the bank for rediscount. In general, corporations that rediscount livestock paper have been granted a higher ratio than those that rediscount crop-production paper. Some corporations included in this study have suffered at times a sharp decrease in lines of credit because of an impairment of capital as well as on account of the general reduction in ratios granted by the banks.

The actual amount of loans rediscounted is generally less than the line of credit, the latter representing the upper limit. Table 11 indicates for five corporations the relation between the maximum rediscounts each year and the paid-in and unimpaired capital and surplus. Since the figures for capital and surplus as of the date of maximum rediscounts are not available, the capital and surplus as of the end of the year is used. Capital and surplus as of the first of the year would be too small because much new capital stock is sold

during the lending period. Capital stock at the close of the year, however, represents approximately the amount outstanding at the time of the peak lending period. Surplus figures in some cases are higher at the close of the year than in the peak months and in some cases are lower. Thus it is probable that the paid-in and unimpaired capital and surplus as of the end of the year represents fairly well, in most instances, the basis on which the line of credit was granted.

TABLE 11.—*Ratio of maximum amount of rediscounts each year to the paid-in and unimpaired capital and surplus at the close of the year, for five corporations, 1924–1929*

Year	Corporation A	Corporation B	Corporation C [1]	Corporation D	Corporation E
	Per cent	*Per cent*	*Per cent*	*Per cent*	*Per cent*
1924	(2)	3.91	(2)	(2)	(2)
1925	0.92	(4)	(2)	(4)	7.45
1926	8.53	(3)	0.58	2.12	9.03
1927	3.33	3.23	.85	1.64	(3)
1928	3.50	4.60	.78	1.71	[5] 13.74
1929	4.74	5.37	1.57	2.02	[5] 24.31

[1] Corporation does not devote its full capital to the production credit loans.
[2] Corporation not operating.
[3] Data not available.
[4] No rediscounts.
[5] Ratio in excess of 10 because an analysis of paper at the end of the year showed a large impairment of capital.

The Federal intermediate credit banks are dependent on the capital of the rediscounting corporations as a margin for protection against loss on bad paper; consequently they must be assured that the capital will not be dissipated while the corporations are indebted to them. If that capital were invested in loans to farmers, it could easily be lost, leaving the banks with no margin of protection. The general practice of the Federal intermediate credit banks at present is to require that a substantial part of the capital be invested in approved bonds and pledged with the bank as additional collateral. United States bonds and Federal land bank bonds are commonly purchased for that purpose. At the time this practice was adopted many of the corporations had all of their capital invested in unmatured or uncollectible notes of farmers. In several cases the banks took those notes and used them as additional collateral to secure the rediscounts. The Federal intermediate credit banks have not customarily sold the additional collateral pledged with them if the rediscounts were not liquidated each year. In case the bank planned to continue business with the corporation the succeeding season it often retained the additional collateral and asked that the unpaid balance of individual borrowers be renewed and further fortified by new mortgages.

The decision in this matter by the Federal intermediate credit bank is very important to the corporation. If the bank uses the additional collateral to liquidate overdue notes at the end of the season, the corporation is left without collateral to pledge for a line of credit the next season. Therefore, unless the corporation can collect those debts or get new capital, it will suffer a reduction in its line of credit the succeeding season or possibly find itself entirely without rediscount credit.

Of the five corporations of which detailed studies were made prior to 1930, only one had cleaned up its account each year. Another had liquidated its account in all but one year. The three others had not followed this practice either because the Federal intermediate credit banks had not insisted on it or else because the corporations were unable to do so. One of the five corporations has not been able to liquidate its debt to the bank since it opened the account.

VOLUME OF REDISCOUNTING

Total rediscounts by years for each corporation (except three small organizations) are shown in Table 12 and Figure 5. The data represent in most cases the largest month-end balance of the rediscounts account for each season. Since the peak of rediscounts was probably reached on some day of the month other than the last, it is probable that these figures are somewhat understated. Loans rediscounted with the Federal intermediate credit banks reached a peak in 1926 of more than $7,000,000. That year was followed by a considerable recession in volume of business, but of late years the volume has again mounted, reaching a new peak in 1930.

TABLE 12.—*Total rediscounts with Federal intermediate credit banks by 11 corporations, 1924–1930*

[The data in many cases represent the largest month-end balance of the rediscounts account for each season]

Corporation	1924	1925	1926	1927	1928	1929	1930	Total
	Dollars	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*
A		96,975	1,430,779	586,237	585,976	819,514	920,486	4,439,967
B	440,000	465,000	1,300,000	875,000	1,701,000	2,625,000	[1] 4,700,000	12,106,000
C	0	0	112,965	257,050	238,324	491,4[illegible]	575,863	1,675,678
D		0	112,645	149,494	170,501	225,609	[1] 250,000	908,549
E		1,331,000	2,005,000	1,094,000	880,000	394,000	[1] 80,000	5,784,000
F	1,049,080	2,048,386	2,465,867	[1] 615,000	[1] 485,000	[1] 400,000	[1] 400,000	7,463,333
G				68,985	250,673	715,474	(2)	1,035,132
H [1]				20,340	49,000	75,000	(2)	153,340
I						10,580	55,385	65,965
J [1]			43,000	68,000	(2)	(2)	(2)	111,000
K [1]							270,000	270,000
Total	1,489,080	3,941,361	7,470,256	3,743,106	4,360,774	5,756,653	7,251,734	34,012,964

[1] Estimated. [2] Corporation not operating.

The agricultural credit corporations organized by the cotton cooperative associations have been responsible for a large part of the discount credit extended by the Federal intermediate credit banks in various States and sections of the country. Table 13 shows the ratio of the discounts for these corporations to the total discounts for crop production by the same banks and to the total discounts for all purposes. The corporations in Mississippi that are included in this study accounted for 98 per cent of the total amount granted in that State in 1929 and 1930 by the Federal intermediate credit bank of the district. In California, on the other hand, the corporation furnished less than 1 per cent. For all of the States listed the corporations mentioned furnished about one-half of the production credit and about one-fifth of all discounts granted by the Federal intermediate credit banks. In the States that are primarily cotton producers the corporations mentioned furnished one-third

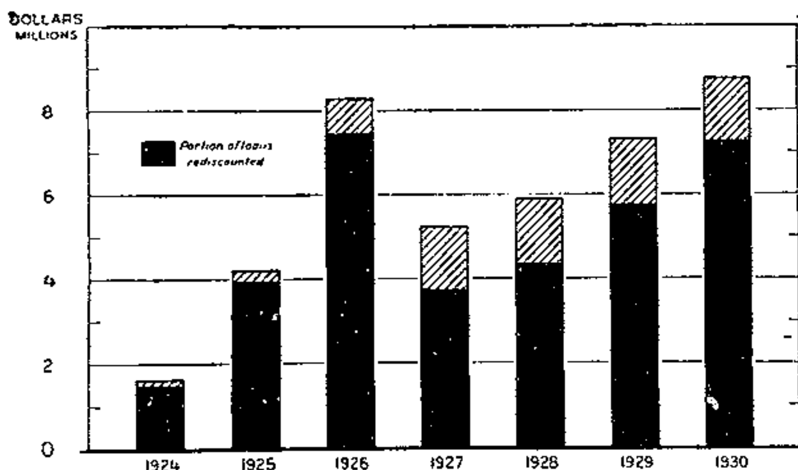

FIGURE 5.—TOTAL PRODUCTION LOANS AND REDISCOUNTS OF AGRICULTURAL CREDIT CORPORATIONS ORGANIZED BY COTTON COOPERATIVE MARKETING ASSOCIATIONS

The increase in volume of loans has been relatively uniform, except in 1926. Rediscounted loans in the last half of the period have formed a smaller portion of the total than in earlier years.

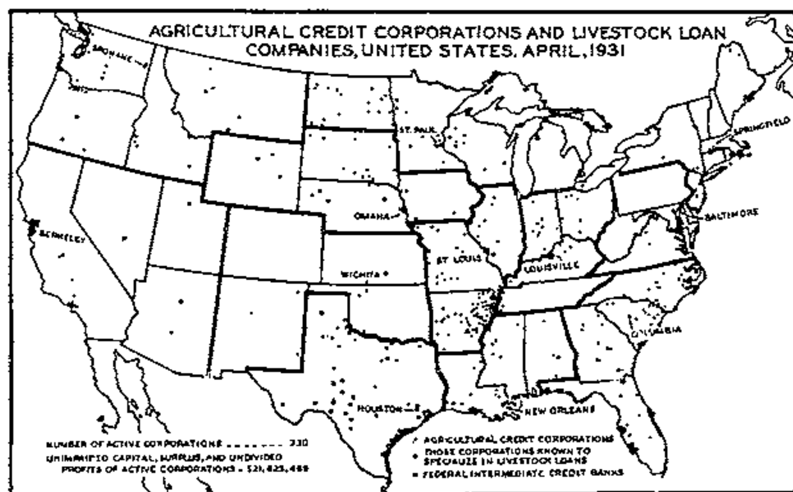

FIGURE 6.—Agricultural credit corporations and livestock loan companies appear to have their most extensive development in Arkansas. Other areas such as the Southeastern States, the North Central States, and Texas appear to have a considerable number of such organizations. An entirely different situation might appear, however, if the volume of business were considered. The volume of original discounts closed by the Federal intermediate credit banks in 1930 was largest for Texas, and next largest for California, Louisiana, and Mississippi in the order named

or more of the crop-production credit and about one-sixth of all credit granted by the banks. Finally, the corporations included in this study rediscounted in 1929 and 1930 approximately one-fourth of the crop-production credit loans advanced by the 12 intermediate credit banks of the country and approximately one-tenth of the total discount credit extended for all purposes. It is obvious, therefore, that although in number the credit corporations organized by the cotton cooperative associations represent a small proportion of the total (fig. 6) they have accounted for a large part of the business of the Federal intermediate credit system.

TABLE 13.—*Ratio of discounts of the Federal intermediate credit banks for agricultural credit corporations organized by the cotton cooperative marketing associations to all discounts for crop production and to all discounts,*[1] *1929 and 1930*

Territory	Percentage of discounts for crop production purposes		Percentage of all discounts	
	1929	1930	1929	1930
	Per cent	*Per cent*	*Per cent*	*Per cent*
Georgia	51	55	51	55
Alabama [1]	54	38	51	32
Mississippi	99	98	99	98
Texas and New Mexico	91	86	3	4
South Carolina	8	0	8	0
North Carolina [2]	20	21	20	21
California	.5	2	.2	.6
Tennessee	99		94	
Tennessee, Arkansas, and Missouri		18		12
All States listed	50	51	18	21
All cotton States except Florida, Virginia, and Arizona	33	30	15	18
United States	27	27	9	10

[1] Original discounts. [2] Estimated.

Table 14 shows the ratio of rediscounts to loans. The first part of the table shows the ratio at the peak of lending and is obtained by dividing the total amount of rediscounts for the year by the total amount of loans (both new and carry-over). The second part of the table is the average ratio for the year. It is obtained by using the month-end balances of the loan and the rediscount accounts. The sum of the 12 month-end balances for the rediscount account each year is divided by the sum of the 12 month-end balances of the loan account. This ratio is in reality the average of the monthly ratios of rediscounts to loans, weighted by the balance of the loan account each month. As a weighted average it is more significant than a simple average of the monthly ratios would be.

TABLE 14.—*Ratio of rediscounts to production credit loans, in specified corporations, 1924–1929*

AS OF PEAK PERIOD

Year	Corporation A	Corporation B	Corporation C	Corporation D	Corporation E	Average
	Per cent	*Per cent*	*Per cent*	*Per cent*	*Per cent*	*Per cent*
1924	(1)	85.8	(1)	(1)	(1)	85.8
1925	97.3	75.4	(1)	(2)	96.4	89.7
1926	92.9	81.6	58.2	85.3	92.8	82.2
1927	92.1	65.4	51.9	73.0	77.0	71.9
1928	77.0	79.5	45.5	62.1	79.3	68.7
1929	75.2	97.5	66.9	57.1	63.5	72.0
Average	86.9	80.9	55.6	69.4	81.8	76.2

AVERAGE FOR THE YEAR

Year	Corporation A	Corporation B	Corporation C	Corporation D	Corporation E	Average
1924	(1)	78.1	(1)	(1)	-------	-----
1925	20.5	50.4	(1)	(2)	-------	-----
1926	80.8	67.6	40.8	79.5	-------	-----
1927	60.9	57.6	45.4	53.5	-------	-----
1928	64.6	71.3	43.7	55.2	-------	-----
1929	67.3	74.8	58.3	46.7	-------	-----
Average	61.8	66.6	47.0	58.7	-------	-----

[1] Corporation not operating. [2] Small volume of loans with no rediscounts.

The ratio of rediscounts to loans at the peak of lending activities averaged 76.2 per cent and ranged from 45.5 to 97.5 per cent. In other words, these corporations during peak periods were borrowing from the Federal intermediate credit banks about three-fourths of the money they loaned and furnishing the other one-fourth out of their capital or out of funds borrowed from the cotton associations or some other source. The lowest average ratio for any corporation was 55.6 per cent and the highest was 86.9. The low ratio of 55.6 per cent may be explained by the fact that that particular corporation has had a large capital from which to make loans and the further fact that it has borrowed funds from the cotton association during the heavy lending period. Yearly averages for all corporations combined show in general a trend downward from ratios of almost 90 per cent in the early years to ratios of approximately 70 per cent in the later years.

Average ratios for the year as calculated from month-end balances of accounts are available for only four of the corporations. These are much lower than the ratios in the peak periods. In fact the average amount rediscounted throughout the year represents approximately three-fifths of the total instead of three-fourths as shown by the ratio for the peak periods.

There are very few alternate sources of funds for the corporations. At certain times in the year when the funds of the cotton associations have not been in use, the corporations in a few cases have been able to borrow them. At various times some of the corporations have been able to borrow small amounts from commercial banks by pledging some of the notes they held in their portfolios. In general, however, the corporations have depended largely on the Federal intermediate credit banks for their loanable funds.

REDISCOUNT RATES AND MARGINS ALLOWED

Rediscount rates charged by the banks have varied from 4 to 6 per cent. (Fig. 7.) The rediscount rate depends on the interest rate at which the bank has been able to sell its own debentures, for the banks are not permitted by law to charge a rate of discount more than 1 per cent in excess of the interest rate on their most recent issue of debentures. The framers of the law apparently felt that 1 per cent would be a sufficient margin to cover the cost of operation and any losses that might occur. It is doubtful, however, if the 1 per cent margin is sufficient for this purpose in the case of loans rediscounted for agricultural credit corporations. Were it not for the commodity loans to cooperative associations, with the same spread for earnings

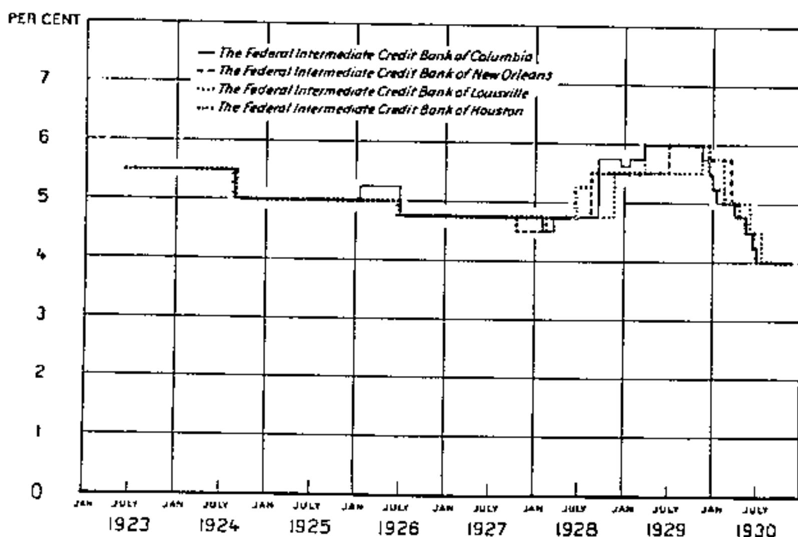

FIGURE 7.—RATES OF DISCOUNT FROM THE DATE OF ORGANIZATION TO DECEMBER 31, 1930, OF FOUR FEDERAL INTERMEDIATE CREDIT BANKS WHICH DISCOUNT PAPER OF COTTON FARMERS

Rates of discount charged by the four Federal intermediate credit banks serving most of the cotton-growing States have varied from 4 to 6 per cent. Rates of 4¾ or 5 per cent were prevalent during most of the years. (Data furnished by Federal Farm Loan Board.)

the banks might be unable to operate at a profit. Such loans are generally large and require less expense per dollar for service than do most rediscounts. The somewhat larger profits that the banks make on their commodity loans tend to offset the heavier expense on the rediscount of farmers' notes.

At present the banks are not permitted to rediscount paper on which the rate charged the borrower is more than 3 per cent higher than the rediscount rate of the bank. When the agricultural credits act of 1923 was passed the margin was set at 1½ per cent, but the Federal Farm Loan Board was given power to change it. Several changes have since been made. On January 7, 1924, the spread permitted on livestock loans was increased to 2 per cent and on January 31, 1925, to 2½ per cent. On January 29, 1927, the spread was increased from 1½ per cent to 2 per cent on general agricultural

paper. The margin was increased again on April 9, 1931, to 3 per cent on all types of paper.

THE BANKS' EXAMINATION OF LOANS

The Federal intermediate credit banks make an analysis of all loans offered for rediscount. In this examination they are seriously handicapped by not having a personal acquaintance with the farmers who apply for loans; they must depend upon the opinions of others to evaluate the personal characteristics of the borrower. As a result the banks must base their analysis largely upon the financial statement of the borrower and other quantitative data obtained by the corporation. The lack of personal relations is a serious handicap to the bank and to the applicant who shows a poor financial statement but who nevertheless is a good personal risk.

CAUSES OF DISSATISFACTION

There has been some dissatisfaction with the Federal intermediate credit banks on the part of these finance corporations. In the early years many corporation officials felt that their corporations should be entitled to a line of credit equal to the maximum permitted under the law and that any reduction in the ratio was unfair and a reflection upon their organizations. Another source of trouble has been the demand of some banks for better security and the refusal to accept loans without such security. Officers of the finance corporations contended that since they were acquainted with the borrower and knew the personal risk involved they were able to judge certain loans better than the banks, which must depend primarily upon a quantitative analysis of the application. Undoubtedly there was some merit in their contention. On the other hand, the banks in the early years had had experience with loans granted at the discretion of officers of credit corporations and in many cases had encountered difficulty in collecting them.

Still another source of dissatisfaction between the banks and the corporations was the fact that the banks have at all times required that the legal papers with regard to loans be flawless. Since they did not know the borrower personally and could not depend on his moral character it was necessary that they leave no loophole to enable him to avoid paying the loan. At present, most of the misunderstandings and difficulties have been fairly well adjusted, and the relationships for the most part are decidedly friendly.

COSTS OF LOANS TO THE BORROWER

One of the purposes of the cooperatives in organizing affiliated agricultural credit corporations was to make cheaper credit available to members. The cost of credit for producing cotton is well known to be high; many have considered it excessive. What has been the experience of these credit corporations in reducing the cost of credit to borrowers?

Legislation by the States to limit the rates of interest that may be charged have led to various subterfuges such as additional fees, flat charges rather than annual rates of interest, and the like. Usury

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laws have also tended to force the financing of the farmer from the banker to the merchant, who may charge what he chooses for interest by merely adding the charge to the price of his goods. Thus, in any analysis of the cost of credit, interest rates are not the only costs to be included. This is as true of credit obtained through an agricultural credit corporation as of credit obtained elsewhere. The following analysis of costs to the borrower takes into account not only the interest charge but also numerous other costs.

RATE OF INTEREST

Figure 7 indicates the rates that have been charged in various years by the four banks that serve most of the cotton States. If the margin allowed agricultural credit corporations of 1½, 2, or 3 per cent, is added to the bank rates, it is possible to get an approximation of the discount rates paid in past years by the borrowers. One corporation, however, has not always taken the full spread allowed.

Table 15 shows the average discount rates that have been charged during the various years by four of the corporations. The high rates in 1929 reflect the general high cost of credit throughout the country. Rates decreased again in 1930 and the first half of 1931.

TABLE 15.—*Approximate rates of discount charged by four agricultural credit corporations, 1924–1929*

Year	Corporation A	Corporation B	Corporation C	Corporation E	Average
	Per cent	*Per cent*	*Per cent*	*Per cent*	*Per cent*
1924		6.25			6.25
1925	6.50	5.75		6.50	6.25
1926	6.75	6.00	6.50	6.75	6.50
1927	6.75	5.88	6.75	6.75	6.53
1928	6.62	5.50	6.75	6.62	6.37
1929	7.88	5.75	7.88	7.88	7.35
Average	6.90	5.86	6.97	6.90	6.60

It should be remembered that the rates shown in Table 15 are discount and not interest rates. A rate used for discount charged in advance is always more costly to the borrower than the same rate used for an interest charge at maturity of the note. Thus 7 per cent discount on a $100 note for one year means the payment of $7 for the use of $93 for 1 year or a rate of interest of 7.53 per cent. For rates below 7 per cent, the difference between the discount and real interest rate is less than 0.53 per cent and for rates above that it is more. Moreover, the difference on an annual basis when loans are for periods of less than one year would be smaller than if the loans were for a whole year as shown above, because the payment of the discount is for a shorter time in advance. Table 16 shows interest rates equivalent to customary discount rates for typical periods.

TABLE 16.—*Interest rates equivalent to specified discount rates*

Annual discount rate	Equivalent annual interest rate on loans of—		
	1 year	9 months	6 months
Per cent	*Per cent*	*Per cent*	*Per cent*
6	6.38	[1] 6.23	[1] 6.19
7	7.53	[1] 7.39	[1] 7.25
8	8.70	[1] 8.51	[1] 8.33

[1] Sometimes referred to as nominal rates of interest. The effective rates, the rates based on compounding interest only once a year, would be as follows: Nine months, 6.33, 7.46, and 8.60; six months, 6.28, 7.39, and 8.51.

FACTORS MODIFYING RATE OF INTEREST IN ASCERTAINING COST TO BORROWER

Several modifications of the discount rates must be taken into account in ascertaining the actual cost to the borrower. These corporations advance the funds to many of their borrowers in installments. With some corporations the practice is almost universal; with others it is used only in a minority of cases. Two of the five corporations studied have charged the borrower for the money from the exact date of each installment advanced him. The other three have charged discount on the whole sum from the date of discounting the note; hence, for these three corporations the real cost to the borrower has been greater than the stated rate. Two of these three corporations were forced to follow this policy; the Federal intermediate credit bank with which they discounted paper did not itself advance the loan in installments, but advanced the total sum to the agricultural credit corporations at the time of rediscount without regard to the installments. Hence it charged the corporations on the full sum from the date of rediscount.

As the corporations kept the funds in a city bank until the installments were due and received very little if any interest thereon, they found it necessary to charge the borrowers for the full period of the loan. The fact that the borrower was required to pay interest on the whole loan from the date of discount regardless of the fact that he received it in installments made the actual rate of discount higher for him than the quoted rate. On the other hand, this extra cost to the borrower was not such a burden or so unfair as it might seem at first thought. If all of the funds were made available to him at the date of discount, he himself would have deposited them in his local bank, probably without interest. It cost him no more to have the funds in a city bank to the credit of an agricultural finance corporation than in a local bank to his own credit.

In finding the true cost of money to the borrower, the matter of refunding of interest on loans paid in full or in part before maturity must be considered. The same two corporations that charge interest only from the date of each installment also refund interest to the borrowers for the period from each payment on the loan until maturity. Moreover, these corporations calculate the interest to the exact day on every payment applied to the loan. The other corporations have not done so well by the borrower.

It has been the practice of one of the Federal intermediate credit banks in refunding discount on payments before maturity to refund the discount at a rate 1 per cent below the rate on its debentures, and not at the rate charged by the bank. It should be remembered that the bank's charges are 1 per cent in excess of the rate on its debentures. Hence if the rate on the bank's debentures has not changed within the period of the loan, it refunds discount on prepayments at a rate 2 per cent below the rate paid. Officials of that bank feel that they have gone to the expense of placing the loan and hence have earned their margin of 1 per cent interest for the full period of the loan. Moreover, since the maturities of the bank's debentures are based on the maturities of the loans it has made, the bank probably has to relend the money and contends that it is entitled to another 1 per cent of the loan from the date of payment to maturity.

Following the same line of reasoning, the corporations feel that they have earned the full margin of income allowed to them for the full period of the loan until maturity and do not see fit to refund to the borrower anything more than the bank refunds to them. Thus the borrower, last in the line, is refunded discount for the unused portion of the term of the loan at a rate which has often been 4 per cent below the rate which he has paid for the money.

Assume, for instance, that the borrower has paid 7 per cent for the money, out of which 2 per cent was the corporation's margin and 1 per cent the bank's margin. If there had been no changes in the rates on debentures of the bank, he would have received a refund of discount for the period from the date of repayment until maturity at 3 per cent. He thus paid 7 per cent for the time he actually had the money and in addition 4 per cent from the date of actual repayment to the date of the maturity of the note. Possibly the borrower is lucky to receive any allowance for payment before maturity. Many of the local banks make no refund whatsoever. Nevertheless, this practice makes the actual rate that the borrower pays somewhat higher than the quoted rate.

Two of the corporations are known to make additional charges in the form of fees. These fees are small, being in one case $3 flat charge and in the other $1 plus 10 cents for every $100 of the loan or fraction thereof. In some cases when it has been necessary to send a special investigator to appraise the security offered for the loan, the cost has been assessed against the borrower.

The borrower is always expected to pay the cost of searching the county records to show what prior liens, if any, exist, and to pay for recording and releasing mortgages or other liens. Generally the borrower himself employs and pays someone to search the records and pays recording fees. In some cases, however, the corporation has this work done and deducts the charges from the face of the loan. By employing someone to take care of all of its work in a county the corporation is often able to have records searched at a much lower cost than the individual would have to pay. For large loans the expenses of recording and searching of records do not add materially to the cost on a percentage basis. But for a loan of $500, which is about the median-size loan, the typical charge for the service of from $2 to $5 is significant in its effect on the rate of interest. Charges

as high as $10 have often been made for searching the records. Such a charge would add as much as 2 per cent to the interest rate on a $500 loan for 1 year or 4 per cent if the loan was for only 6 months.

No estimate of the cost of the loan to the borrower would be complete without taking into account the cost to the borrower of owning stock of the corporation, a practice that is now required by all but one organization. The corporations, with one exception, have not paid dividends on their stock. If the borrower must own nondividend-paying stock for the privilege of obtaining the loan, the loss of return on investment is a proper charge to the cost of that loan.

Assuming that investments in stock should yield 7 per cent (a rate only slightly above the average rate paid as interest by borrowers on their loans) and further assuming that the borrower must take stock equal to 10 per cent of the loan, the loss in dividends would be 7 per cent of 10 per cent of the loan or 0.7 per cent. This is an addition to the interest rate on the loan. Moreover, if the stock of the corporation depreciates in value, that loss in value should also be added to the cost by distributing it over the number of years in which loans were obtained. This is a large item in the case of some corporations whose stock has lost its entire value.

FINAL COST TO THE BORROWER

Table 17 represents an attempt to estimate the cost to the borrower of a typical loan on an annual interest rate basis. The typical loan is taken as one of $500 since that is close to the median size, and 7 per cent rate of discount is selected as being near the average. The final estimate amounts to about 10 per cent. Adjustments must be added to these rates if the loan is made in installments or paid before maturity without a proportional reduction in interest. Additions must be made if the stock of the corporation owned by the borrower has depreciated in value.

TABLE 17.—*Estimated cost, on an annual interest rate basis of a typical loan ($500 at 7 per cent) for designated periods*

Item	12-month note	9-month note	6-month note
	Per cent	*Per cent*	*Per cent*
Rate of annual interest equivalent to 7 per cent annual discount	7.53	7.39	7.25
$4-fees for examining title and recording liens	.80	1.06	1.60
Subtotal	8.33	8.45	8.85
Seven per cent return sacrificed annually on investment in stock of the corporation	.70	.93	1.40
Subtotal	9.03	9.38	10.25
$1.50 fee for application	.30	.40	.60
Total	9.33	9.78	10.85

The cost of loans through these credit corporations compares favorably with the cost through other agencies. Table 2 indicates average costs of cash credit to cotton growers, ranging from 7.7 to 11.5 per cent. Much of this cash credit was obtained from banks. Although farmers with good credit often can borrow at their local

banks for 6, 7, or 8 per cent per annum, banks in many sections make flat charges, sometimes as high as 10 per cent, despite the fact that the loans are of less than a year's duration. For the corporations that have not required the borrower to purchase capital stock, and for those that have, but have paid dividends thereon, the costs of loans compare favorably with bank rates.

The cost of loans through the credit corporations has clearly been much lower than the customary charges for merchant credit. (Table 2.) As a rule, however, the borrower from a credit corporation is a better risk than the average farmer who uses merchant credit. Those farmers who are obtaining their credit at high rates from merchants and who could qualify for a loan from some credit corporation would find such a change a real economy.

In appraising these organizations on the basis of the cost of loans to the borrower, it should be kept in mind that the loans are seasonal and of less than a year's duration. In addition, they often are small and hazardous. All of these factors lead toward high costs of operation, which in turn are reflected in high charges to the borrower, especially when stated on an annual interest basis. All of these characteristics except the one of seasonality are found also in loans to consumers in industrial centers and contribute to the necessity for charging a high rate of interest, as evidenced by Table 18.

TABLE 18.—*Cost on a per annum basis of loans from various agencies extending personal credit in urban areas*

[Data obtained from Financing the Consumer, by Evans Clark, 1930. p. 119]

Agency	Usual charge	Range of charges
	Per cent	*Per cent*
Credit unions	12.0	6.0–18.0
Personal loan departments	18.1	9.4–22.6
Industrial banks	17.3	17.3–34.4
Remedial loan societies	26.9	12.0–36.0
Axias	28.5	
Pawnbrokers	36.0	12.0–120.0
Personal finance companies	42.0	30.0–42.0

The reasonable, if not low, rates charged by agricultural credit corporations must be attributed in large part to the efforts of the Federal Government to aid farmers. It established the Federal intermediate credit banks and contributed all of their capital; it supervises them and grants them the privilege of issuing tax-free debentures. The exemption of the banks' debentures from both Federal and State taxation enables them to be sold to the public at a rate of interest lower than would otherwise be possible. The extent to which the securities sell at lower interest rates because of the tax-free feature depends on the rates of tax at the time. A study of interest rates from 1918 to 1926 indicates an average difference in yield rates, due to tax exemption, of 0.85 per cent.[5] Because of the decrease since then in the surtax rates of the Federal income tax, the difference is much less at present.

[5] ROWE, W. H. THE BURDEN OF TAX EXEMPTION OF GOVERNMENT BONDS. Amer. Econ. Rev. 16: [633]–659. 1926.

INCOME, COSTS, AND PROFITS

One of the problems that agricultural credit corporations throughout the country have had to face is the inadequacy of income and profits. Until 1927 the Federal intermediate credit banks were permitted to rediscount crop paper for the corporations only if the rate of discount charged borrowers was not more than 1½ per cent in excess of the rediscount rate charged by the bank. From 1927 to 1931, a 2 per cent margin on crop-production loans was allowed. In most cases this margin has not proved sufficient for the corporations to pay expenses and absorb losses. The corporations affiliated with the cotton marketing associations were organized for service, and in most cases they have not been expected to earn a profit for the stockholders but it has been hoped that they would at least be self-supporting.

OPERATING STATEMENTS

Complete data relative to income and operating expenses are available for four corporations only. Limited data covering income and interest expense are available for a fifth. Table 19 contains a summary operating statement of each of these corporations for the full period of its life and a combined statement for all corporations for all years. The table also shows the expenses and profits in percentage of total income.

TABLE 19.—*Operating statements for five agricultural credit corporations covering period from date of organization to the close of the 1929 calendar or fiscal year*[1]

Item	Corporation A (5 years)		Corporation B (5 years)		Corporation C (4 years)		Corporation D (5 years)	
	Dollars	*Percent*	*Dollars*	*Percent*	*Dollars*	*Percent*	*Dollars*	*Per cent*
Income	249,095	100.0	158,564	100.0	111,757	100.0	60,182	100.0
Interest cost	137,487	55.2	75,932	47.9	32,780	29.3	28,384	47.2
Gross profits	111,608	44.8	82,632	52.1	78,977	70.7	31,798	52.8
Other operating expense	89,886	36.1	....	....	75,111	67.2	33,365	55.4
Net operating profit	21,722	8.7	....	....	3,866	3.5	−1,567	−2.6
Other adjustments[1]	1,611	.7	....	....	−367	−.4	....	....
Net profit or loss[1]	23,333	9.4	....	....	3,499	3.1	−1,567	−2.6

Item	Corporation E (5 years)		Total		Total of corporations A, C, D, E	
	Dollars	*Percent*	*Dollars*	*Percent*	*Dollars*	*Per cent*
Income	283,498	100.0	563,096	100.0	704,532	100.0
Interest cost	172,069	60.7	446,652	51.7	370,720	52.6
Gross profits	111,429	39.3	416,444	48.3	333,812	47.4
Other operating expense	127,600	45.0	....	....	325,962	46.3
Net operating profit	−16,171	−5.7	....	....	7,850	1.1
Other adjustments[1]	−7,934	−2.8	....	....	−6,690	−.9
Net profit or loss[1]	−24,105	−8.5	....	....	1,160	.2

[1] This table does not include the losses incurred on loans by some of the corporations.

Income and expense figures available for four corporations have been classified also on the basis of years and are shown in Table 20. Being a combined statement of profit and loss this table shows cer-

tain trends in the industry as a whole. Both income and interest costs reached their high point in 1926. Profits from operations were earned in 1925 and 1926; in 1928 interest and operating expenses about equaled the income. Losses were sustained on operations in 1927 and 1929.

It is probable, however, that these totals are too greatly influenced by figures of individual corporations for many general conclusions to be drawn from them. Undoubtedly the profits shown from operations in 1925 and 1926 were partly due to handling a large volume of business without sufficient servicing of the loans. The year 1927 was one of retrenchment. New loans were restricted, and old ones were collected, with the result that the earnings from interest were small and expenses were high.

TABLE 20.—*Summary of the operating statements of four agricultural credit corporations, 1925–1929*

Item	1925		1926		1927	
	Amount	Percentage of total income	Amount	Percentage of total income	Amount	Percentage of total income
	Dollars	*Per cent*	*Dollars*	*Per cent*	*Dollars*	*Per cent*
Income	76,338	100.0	215,824	100.0	153,060	100.0
Interest costs	47,077	61.7	129,905	60.2	73,967	48.3
Gross profit	29,261	38.3	85,919	39.8	79,093	51.7
Other operating expense	15,968	20.9	60,594	30.9	96,873	63.3
Net operating profit	13,293	17.4	19,325	9.0	−17,780	−11.6
Other adjustments	−4,071	−5.3	−10,424	−4.8	7,143	4.7
Net profit or loss	9,222	12.1	8,901	4.1	−10,637	−6.9

Item	1928		1929		Total [1]	
	Amount	Percentage of total income	Amount	Percentage of total income	Amount	Percentage of total income
	Dollars	*Per cent*	*Dollars*	*Per cent*	*Dollars*	*Per cent*
Income	142,695	100.0	134,248	100.0	722,165	100.0
Interest costs	63,435	44.5	61,396	45.7	375,780	52.0
Gross profit	79,260	55.5	72,852	54.3	346,385	48.0
Other operating expense	79,172	55.5	76,242	56.8	334,849	46.4
Net operating profit	88	.1	−3,390	−2.5	11,536	1.6
Other adjustments	−11,904	−8.3	12,566	9.4	−6,690	−.9
Net profit or loss	−11,816	−8.3	9,176	6.8	4,846	.7

[1] Total figures do not exactly agree with those of Table 19 because estimates were necessary to change the basis of the statements of one corporation from a fiscal to a calendar year.

Expenses for each corporation have been classified in five groups and are shown for each of the four corporations in Table 21 in which are also given the percentages each group of expenses constitutes of the total expenses and of the total income. Salaries were by far the

largest class, and traveling or field expense, the second largest item. Office expenses were the third in size, but of much less importance than salaries or traveling expenses. Taxes, Government fees, and miscellaneous expenses were of relatively small importance. The expenses, exclusive of interest costs, absorbed 46.3 per cent of the income.

TABLE 21.—*A classification of operating expenses, other than interest costs, for four corporations from the date of organization of each to the close of the 1929 calendar or fiscal year*[1]

Item	Corporation A			Corporation C			Corporation D		
	Amt.	Percentage of total		Amt.	Percentage of total		Amt.	Percentage of total	
		Expense	Income		Expense	Income		Expense	Income
	Dollars	*P. ct.*	*P. ct.*	*Dollars*	*P. ct.*	*P. ct.*	*Dollars*	*P. ct.*	*P. ct.*
Salaries	47,793	53.2	19.2	50,633	79.4	53.3	25,528	70.5	42.4
Traveling and other field expense	25,876	28.8	10.4	9,479	12.6	8.5	3,312	9.9	5.5
Office expense	9,770	10.9	3.9	3,351	4.5	3.0	1,933	5.8	3.2
Taxes and Government fees	216	.2	.1	1,234	1.6	1.1	725	2.2	1.2
Miscellaneous expense	6,226	6.9	2.5	1,414	1.9	1.3	1,867	5.6	3.1
Total	89,886	100.0	36.1	75,111	100.0	67.2	33,365	100.0	55.4

Item	Corporation E			Total		
	Amount	Percentage of total		Amount	Percentage of total	
		Expense	Income		Expense	Income
	Dollars	*P. ct.*	*P. ct.*	*Dollars*	*P. ct.*	*P. ct.*
Salaries	75,273	59.0	26.5	208,232	63.9	29.6
Traveling and other field expense	25,543	20.0	9.0	64,210	19.7	9.1
Office expense	11,509	9.0	4.1	26,563	8.1	3.8
Taxes and Government fees	3,105	2.4	1.1	5,280	1.6	.7
Miscellaneous expense	12,170	9.6	4.3	21,677	6.7	3.1
Total	127,600	100.0	45.0	325,962	100.0	46.3

[1] This table is a supporting schedule for the statements shown in Table 19.

OPERATING FIGURES PER LOAN AND PER DOLLAR OF LOAN

The difficulties of the corporations in earning a satisfactory income become more apparent when the figures for income, costs, and profits are examined in terms of averages per loan and per dollar of loan. Table 22 shows the average income, interest paid, expenses, and profits per loan and per dollar of loan. The income per loan is dependent, of course, on the size of the loan as well as the rate. This fact explains very largely why the average income per loan for one corporation is $36 and for another is $328. Average figures for income, interest cost, expenses, and profits per dollar of loan are also significant.

TABLE 22.—*Average income, costs, and profits for five corporations*

PER LOAN

Corporation	Years included	Income	Interest costs	Excess of income over interest costs	Operating expense	Operating profit	Net profit or loss
	Number	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*
A	4	53	30	23	19	4	4
B	5	328	157	171	----	----	----
C	4	75	22	53	50	3	2
D	5	92	43	49	51	−2	−2
E	5	36	22	14	16	−2	−3
Average:							
5 corporations	----	57	30	27	----	----	----
4 corporations	----	48	26	22	22	(1)	(1)

PER DOLLAR OF LOAN

Corporation	Years included	Income	Interest costs	Excess of income over interest costs	Operating expense	Operating profit	Net profit or loss
A	4	$0.0575	$0.0326	$0.0249	$0.0209	$0.0040	$0.0043
B	5	.0256	.0122	.0134	----	----	----
C	4	.0574	.0168	.0406	.0386	.0020	.0018
D	5	.0576	.0272	.0304	.0319	−.0015	−.0015
E	5	.0424	.0257	.0167	.0191	−.0024	−.0036
Average:							
5 corporations	----	.0425	.0221	.0204	----	----	----
4 corporations	----	.0501	.0266	.0235	.0234	.0001	.0003

[1] Less than 50 cents profit.

REASONS FOR SMALL PROFITS

One of the principal causes of the difficulties encountered by these agricultural credit corporations in making a profit or at least avoiding a loss is the seasonal character of the loans. Advances are started in the late winter or early spring; they rise to a peak in August, and are largely liquidated by the end of October or November. (Fig. 8.) The average annual earning period of the loans is from 6 to 7 months as shown in the following tabulation:

Year	Months
1925	6.1
1926	6.8
1927	7.1
1928	6.5
1929	6.5
1930	6.9
Average	6.65

This estimate is obtained by an analysis of the area under the curve in Figure 8. Its accuracy is supported by the results of other studies made in the cotton States. Of those studies, four show the average term of loans for growing the crop. These were found to be 6.8, 7.0, 7.4, and 6.8 months, respectively.

If interest is charged only for the time during which the loans are outstanding, the income of the corporation is limited to about one-half of what it would be were it able to maintain a constant volume of business equal to its full line of rediscount credit. Expenses, on the other hand, are but little less than would be the case if the loan volume were at a maximum level throughout the year. This is partly because it is desirable to maintain a permanent staff, and hence, salaries, the largest item of expense, can not be reduced during the

winter months. In fact, there are only one or two months during the year when the force is not busy either with collections or the making of new loans.

The fact that profits are small may also be attributed to the high costs of operating over a wide territory. Most of the corporations included in this study operate throughout a whole State, and the loans are often widely scattered. It is not uncommon to find only one loan in a county. Under these conditions, the expense of providing even a minimum amount of supervision over the loans is excessive. The manager himself is not able to cover the territory, and a field staff must be employed. Automobiles must be provided and maintained, and living expenses must be paid while the field men are away from home. Long-distance telephone calls are often necessary for the

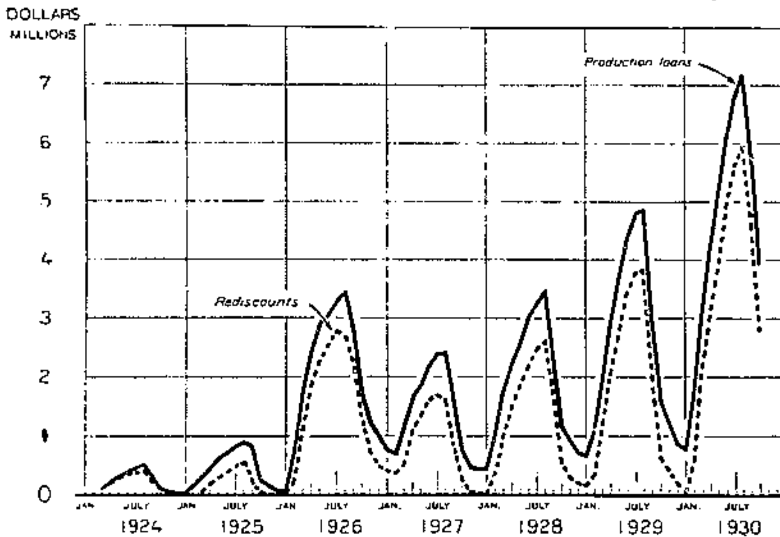

FIGURE 8.—PRODUCTION LOANS AND REDISCOUNTS FOR FOUR AGRICULTURAL CREDIT CORPORATIONS

The shape of the curves indicates the extreme seasonal character of the business. Loans start in the late winter or early spring, rise to a peak in August, and are largely liquidated by the end of October or November. (Data on which these curves are based consist of the month-end balances of the loan and the rediscount accounts.)

field force to keep in touch with the corporation office. Because of the scattered character of the business, much correspondence is necessary; a sample of 12 loans of one corporation indicated an average of 24 pieces of correspondence per loan. Excessive correspondence means a large outlay for stenographic service and postage.

Another factor contributing to the scarcity of profits has been the small size of the loans. Table 22 indicates that for four corporations, in which the average size of loan was $965 and the median size was $494, the excess of income over interest costs per loan was $22, whereas for a fifth corporation whose loans averaged $13,457, the excess of income over interest cost was $171 per loan. Since the cost of making and servicing a small loan is little if any less than the cost for a large loan it is obvious that the small size of loans constitutes a real handicap.

One of the most important causes of the unprofitable showing made by the corporations has been the inadequacy of operating margins on rediscounted loans. If reference is made to Table 22, it may be observed that the average cost per dollar of loan, exclusive of interest costs for four corporations, was 2.34 cents, whereas the income from rediscounted loans under the 2 per cent spread effective until April, 1931, was as much as 2 cents only if the loan had been outstanding the full year.[6] Actually the loans were outstanding only about seven months. It is obvious that in the case of those corporations the income from rediscounted loans was insufficient to meet the operating expenses. It was only through the income from loans not rediscounted on which the corporation earned the full interest collected that the corporations were able to come through the years without a large operating deficit.

COMPARISON WITH EARNINGS AND EXPENSES OF BANKS

The insufficiency of the 1½ per cent and the 2 per cent spread in earnings may be further shown by a comparison of the earnings and expenses of these corporations with those of commercial banks. A comparison was made of the operating ratios of the corporations, those of all member banks in the Federal reserve system, and those of national banks outside of reserve cities in the same four States as these agricultural credit corporations.[7] This latter group of banks operates under conditions similar to the conditions under which the credit corporations operate. Table 23 and Figure 9 show a comparison of the interest costs, operating expenses, and profits of these banks and the credit corporations, expressed as percentages of total income.

TABLE 23.—*A comparison of the operating results of banks and agricultural credit corporations*

[Data for the banks were obtained from the Federal Reserve Bulletin for July, 1930, and the Report of the Comptroller of Currency for 1929]

Item	Member banks, Federal reserve system, 1929		National banks outside of reserve cities in the same four States as the credit corporations, 1929		Four agricultural credit corporations, 1925–1929			
					Actual		Estimated for 1 per cent additional margin of income	
	1,000 dollars	*Per cent*	*1,000 dollars*	*Per cent*	*Dollars*	*Per cent*	*Dollars*	*Per cent*
Income	2,474,096	100.0	58,080	100.0	704,532	100.0	784,803	100.0
Interest costs	823,525	33.3	14,612	25.2	370,720	52.6	370,720	47.2
Gross profit	1,650,571	66.7	43,468	74.8	333,812	47.4	414,083	52.8
Other operating expenses	860,192	34.8	26,109	44.9	325,962	46.3	325,962	41.5
Net operating profit	790,379	31.9	17,359	29.9	7,851	1.1	88,121	11.2
Net adjustments	−233,865	−9.4	−6,937	−11.9	−6,690	−.9	−6,690	−.9
Net profit[a]	556,514	22.5	10,422	17.9	1,161	.2	81,431	10.4

[a] Reliance should not be placed upon the final net profit figures of the corporations because the losses sustained by some corporations were not included in the adjustments to operating profit.

[6] Although the excess of income over interest cost per dollar of loan is shown in Table 22 to be more than 2 cents, that excess is due in part to the fact that 25 to 40 per cent of the loans are not rediscounted.

[7] Data for the banks were obtained from the following publications: FEDERAL RESERVE BOARD. EARNINGS AND EXPENSES OF MEMBER BANKS. Fed. Reserve Bul. 16: 411–413, 1930. POLE, J. W. REPORT OF THE COMPTROLLER OF THE CURRENCY. IN ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES * * * 1929. 1930.

Whereas the corporations paid out 53 per cent of their income for interest, the national banks in the same four States paid only 25 per cent and the banks in the Federal reserve system 33 per cent. Other operating expenses of the corporations took up 46 per cent of their income, those of one group of banks 45 per cent, and those of the other group 35 per cent. The small interest costs for banks, particularly the ones in the Southern States, reflect the fact that a large part of the loanable funds is obtained from noninterest-bearing demand deposits. As a matter of fact, a large part of the operating expenses of these banks is really part of the cost of getting loanable funds, for much of the labor cost is attributable to the deposit activities of the banks rather than to their direct-lending operations.

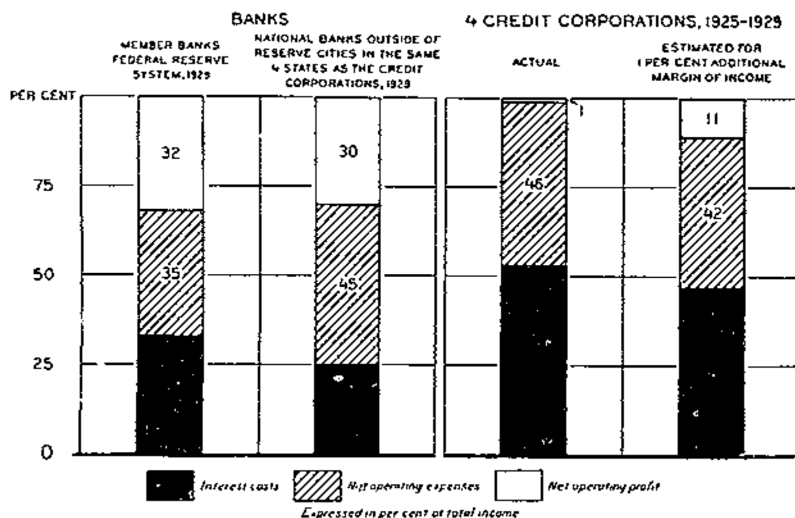

FIGURE 9.—OPERATING RESULTS OF BANKS AND AGRICULTURAL CREDIT CORPORATIONS

The operating results of four agricultural credit corporations are here compared with the operating results of national banks outside of reserve cities in the same four States and with those of the member banks of the Federal reserve system. The corporations earned a much smaller percentage of profit than either group of banks. The operating profits would have increased from 1 to 11 per cent if the corporations had earned an additional 1 per cent of interest on their loans. (Data for banks were obtained from the Federal Reserve Bulletin, July, 1930, and the Report of the Comptroller of Currency for 1929.)

Whatever the proper division may be between cost of getting funds to lend and other operating expenses of the banks, the fact stands out clearly that the sum of these two items represents to the banks only about 70 per cent of the income, whereas for the corporations it represents 99 per cent. Thus the corporations have an operating profit of 1 per cent, as compared with the 30 per cent for the banks.

The data in Table 23 on which Figure 9 is based are taken from the period prior to the date on which the corporations were permitted to increase their margin of earnings to 3 per cent. The last section of Table 23 and of Figure 9 indicate what the ratios would have been if an additional 1 per cent margin had been allowed. Net operating profit would have been 11 per cent of the income, assum-

ing that the increase of earnings would have had no effect on the volume of loans and the amount of expenses.

It is probable that the increase of operating spreads allowed the corporations will have a wholesome effect on this system of farm credit. The previous limitation of rates was an effort to protect the farmer, but to a certain extent the effort was self-defeating. Profits were so limited that private capital seeking profitable investment did not freely enter the business. As a consequence, borrowers have had to purchase the stock of the corporations themselves, and thus in a sense they have obtained loans only by cooperative endeavor. As a consequence of their investment in the corporations, on which they have usually suffered a loss of income and often of principal, their loans have cost them more than the regular interest charge.

If the additional profit allowed the corporations will attract private capital or if it will enable the borrower stockholders to obtain a return on their investment in the form of dividends on their stock, the increase in rates will be well worth while. Nor is it probable that the added margin of earnings permitted the corporations will make the costs to the borrower so high that this type of credit will not be wanted by the farmer. The average borrower of these corporations is interested in getting the advance of credit at any reasonable rate and is not borrowing to save the small excess of interest he would pay elsewhere.

SUPPLEMENTARY SOURCES OF INCOME

Because the income from interest was insufficient to meet the needs of these corporations several of them have found supplementary sources of revenue. One of the most successful attempts to add a source of revenue has been the practice on the part of a certain corporation of trading in its own stock, a discussion of which is included below. Another of the corporations attempted to add the selling of fertilizer as an additional line of activity, but the Federal intermediate credit bank refused to rediscount the paper originating in such sales on the ground that it was mercantile rather than agricultural paper. Some corporations sell fertilizer through a supply corporation, also a subsidiary of the cotton cooperative associations, but in such cases the profits do not go to the finance company itself but to one of the group of organizations of which it is a part.

INCOME-TAX PROVISIONS

The provision of the internal revenue act that exempts agricultural credit corporations affiliated with farmers' cooperative marketing associations from corporate-income taxation is seldom used. But it is interesting that such corporations are exempt if the dividend rate is limited. The following paragraph is taken from section 103 of the revenue act of 1928 from among the list of organizations specifically exempted.

(13) Corporations organized by an association exempt under the provisions of paragraph (12), or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation

or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate directly or indirectly, in the profits of the corporation, upon dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

At least three of the corporations studied have provisions limiting the amount of dividends that can be paid and thereby qualify for exemption from the Federal income tax.

DIVIDENDS, RESERVES, AND SURPLUSES

Little need be said regarding the dividend and reserve policies of these corporations. Only one corporation pays dividends and that is made possible largely because the cotton association pays the operating expenses. The dividend rate of this corporation is 8 per cent. The other corporations, with one exception, have not had sufficient earnings to pay dividends.

The size of reserves has generally been determined by the amount available and not by the need for them. One corporation made a special charge to borrowers of 1 per cent of the loan to be placed in a "reserve for losses," but this practice has been discontinued.

Accumulations of surplus have been small with the exception of those of the corporation mentioned above which turned its reserves for losses into the surplus account. In some cases large deficits have occurred. Table 24 shows the status of the net worth of five corporations as of the close of the 1929 lending season.

TABLE 24.—*Capital stock, surplus, and deficits for five corporations as of the close of the 1929 season*

Corporation	Capital stock	Reserves	Surplus or undivided profits	Deficit	Estimated losses not shown in balance sheet	Net worth
	Dollars	*Dollars*	*Dollars*	*Dollars*	*Dollars*	*Dollars*
A	150,000		22,968			172,968
B	365,352	21,810	102,958		2,500	487,620
C	300,000	8,970	6,899		43,000	272,869
D	113,350			1,569	38,000	73,781
E	275,660			21,523	237,933	16,204
Total	1,204,362	30,780	132,825	23,092	321,433	1,023,442
	Per cent	*Per cent*	*Per cent*	*Per cent*	*Per cent*	*Per cent*
Percentage of capital stock	100.0	2.56	11.03	1.92	26.69	84.98

SPECIAL PROBLEMS OF CREDIT CORPORATIONS

OWNERSHIP OF STOCK BY BORROWERS

It has been practically impossible to sell the stock of these credit corporations to investors seeking profitable investments. Furthermore, few of the cooperative associations were able or inclined to buy all or even a large part of the stock themselves. As a consequence, borrowers in most of the corporations have been required to buy stock as a condition of getting the loan. The amount of stock that the borrower has been required to own has usually been 10 per

cent of the loan. This plan, adopted in the early years, was modeled somewhat after the national farm loan associations of the Federal land bank system. The ownership of the corporation by the borrowers makes the enterprise very much of the nature of a farmers' cooperative organization.

In the case of some of the corporations, the borrowers were permitted to purchase the stock out of the funds obtained from the loan. Thus those individuals were able to purchase the stock and pledge it as security without the advance of any funds of their own. The legal department of the Federal Intermediate Credit Bank of Columbia has ruled that such use of funds obtained from the bank is illegal under the terms of the law, on the grounds that it is not an agricultural purpose. This bank requires all borrowers to state in writing that none of the funds obtained from the bank will be used for the purchase of stock of an agricultural credit corporation.

It has sometimes been implied that collateral in the form of stock bought out of the proceeds of the loan is no better than none because the individual himself contributes nothing as security, the bank not only furnishing him money but also buying his stock. This implication is only partly true.

The matter may be considered from two points of view. From the standpoint of the security of the corporation on each particular loan such practice does not materially aid the corporation. It results in a debt approximately 10 per cent larger than would otherwise have occurred. If the farmer is unable to repay any more than the portion of the loan that went into the crop, then the additional security in the form of unpaid stock is ineffective as collateral. The corporation may resell it, but in that event, the corporation is no better off than if the borrower had never owned the stock. The only added advantage which the corporation has is that its claim against the borrower, after all other security has been exhausted, is larger than it would have been without the stock arrangement. This additional claim may be effective if a judgment is secured or may be well worth while if the following crop is successful.

From the standpoint of the security for the group as a whole, however, much can be said for the plan of requiring the borrowers to take stock even though they pay for it out of the loans. Although some individual borrowers may not be able in the fall to pay for their stock in addition to repaying the loan on their crops, many of them will. The amount thus paid in will provide the corporation with a capital fund to meet the losses on those accounts that can not be collected. Thus for the group as a whole, stock purchased out of the proceeds of the loans serves fairly well for security although not so well as stock purchased for cash.

One of the most objectionable features of the ownership of stock by the borrowers is that the situation is often misunderstood. The borrower, a farmer who has very little acquaintance with financial matters, considers that the stock he has been required to buy is of the same nature as the note he has given to the corporation. He often feels that if he repays his note the corporation should refund him the value of the stock. In many cases where it has been difficult to collect the loan, the borrower has contended that if the corporation would repay him the value of his stock he would pay to the corpora-

tion the balance on his loan. He often feels it an injustice that he should be required to pay his note in full and yet not get back the money he contributed to the formation of the corporation. Such a misunderstanding causes trouble and gives the corporations and the Federal intermediate credit system a bad reputation. In fact, some persons have felt that this is the principal reason why the practice should be abandoned.

The enforced purchase of stock by borrowers is made more unsatisfactory by the frequent occurrence of depreciation in the value of the stock. The value is largely dependent upon four factors: (1) Dividends received, (2) services received, (3) the market for the stock, and (4) its ultimate liquidating value. Dividends have been paid on the stock of only one of the corporations in this study. Consequently, return on investment in the form of dividends does not contribute toward supporting the value except in that one case. The service received by many individuals is sufficient to justify the ownership of the stock, and if the borrower is satisfactorily obtaining a loan every year he has little desire to get rid of his stock. In such cases, the stock continues to have a value for the owner. But in the case of persons who have discontinued borrowing the situation is entirely different. They are able to benefit from the stock neither through dividends nor through service. Moreover, there is practically no market for the stock. Some corporations act as resale agents, selling the stock to new borrowers, but most of them are unable either legally or financially to repurchase the stock for holding in the treasury. Consequently, there is a ready market for the stock only while the corporation is expanding and gaining more borrowers than it is losing.

One of the credit corporations makes trading in its own stock an important supplementary source of income. Borrowers are required to buy stock in order to obtain a loan, and stock purchased from sources other than the corporation is not acceptable. Partly for this reason and partly because the stock does not pay dividends, there is no buyer for the stock except the corporation itself, and, being the sole party interested in buying the stock, the corporation can set its own price.

The price it offers depends on the borrower's record. If his account has been hard to collect and has thus involved extra expense, the corporation will not offer full value for the stock. If on the other hand the individual's account has been a good one, and he does not need to borrow further, the corporation will buy his stock for the full value. But since most of those who do not borrow again have had unsatisfactory records, the price is usually much below par value. In fact, the average price paid has been slightly less than 50 per cent of par value. The owner sells at that price because it is his only opportunity to sell. The corporation then resells this stock at par value to new borrowers and makes a substantial profit. At the time the study of that corporation was made, the profits from this source had been about sufficient to absorb all of the losses on loans.

In addition to providing supplementary income, this practice has brought about some very satisfactory results. The capital of the

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corporation, which would otherwise have been impaired through losses on loans, is kept intact and the balance sheet shows a surplus rather than a deficit. Had the corporation sold new stock to new borrowers instead of treasury stock the corporation would have acquired more funds, it is true, but the capital would have been impaired from losses on loans. With the capital impaired and a large amount of nondividend-paying stock in the hands of previous borrowers with no buyer to take it, the market value of the stock would have dropped very near to zero, and would probably have reflected on the credit of the company. Under the present plan the corporation's stock has a probable liquidating value equal to par and a market value equal to par for those borrowers whose accounts are satisfactory.

It has been contended that the above plan is merely another means of increasing the charge for the loan. That is true not only of this plan but of practically all plans that require the borrower to buy stock. Borrowers in most cases must purchase stock if the credit corporations are to be organized at all, because others will not invest in a business that can not operate at a profit. The cost of the loan to the borrower thus includes more than the interest paid. But the plan outlined is one by which the extra charge is largely placed upon the borrower who contributes to the high cost of doing business by failing to pay his loan promptly. In consideration of the extra service required on his loan and the extraordinary risk involved in his case, the cost to him is probably not excessive. If the loans were all as difficult to collect and as hazardous as his the corporation would probably fail and the stock would be worth nothing.

The desirability of this plan depends largely on the character of its administration. Improperly used it can work a serious injustice. Properly administered it can be equitable and still provide a substantial supplementary revenue.

LOCAL LOAN GROUPS

Several of the corporations have experimented with local loan groups. These are unincorporated organizations of borrowers, usually confined to one locality or county, which operate as local contacts for State corporations. Borrowers are expected to own stock of the State corporation and all members of the group mutually pledge the stock they own for loans of all others in the group. In other words, the stock of all members of the group is pooled as a guarantee of any and every loan within that group.[8]

The advantages of this plan are (1) that the mutual guarantee strengthens the loans, (2) many of the weaker credit risks are eliminated, for members of the groups will not want to admit them, and (3) the corporation is able to dispense with some of the field work which otherwise would be necessary, for the officers of the local groups will do part of that work. Moreover the cost of field work will be kept at a minimum, for loans will be concentrated in certain sections.

There are several objections to this plan. In the first place, the State corporation can not grant to the local groups the discretion which they often want in making the loans, for the guarantee (stock

[8] See appendix for a sample copy of such an agreement.

equal to 10 per cent of the total loans) is too small to warrant the grant of such wide powers. In the second place, farmers are often too independent to want to combine with others and guarantee the payment of their notes even to a limited extent.

Whereas cooperative credit societies are common among European farmers, the American farmer is an individualist. But necessity may drive him to cooperate. It is of interest that four corporations in the cotton States adopted this plan in 1931, although these four are not all affiliates of the cotton-marketing associations. If prosperity returns to the cotton farmer, it is possible that he will become dissatisfied with absorbing the losses of others and will break away from the local groups. Unfortunately he does not realize that when he deals independently with a bank or credit merchant he pays for the losses of the others in the form of interest or other charges.

A modification of this plan of mutual guarantee by a local group is found in one of the corporations. Some of its loans are arranged for it through local banks and are partially or in full guaranteed by them. Instead of the borrowers buying stock, the bank itself may do so on its own account. By pledging all of this stock as security for any and every loan placed through it, a special reduction in the cost of the loan to the borrower is obtained.

EXTENT OF AFFILIATION WITH COOPERATIVE MARKETING ASSOCIATION

Just how closely the cooperative marketing association and the credit corporation should be affiliated is an unsettled question. The question whether a cooperative marketing association should purchase the stock of its affiliated credit corporation might be considered first. Various practices are found among the cotton associations. The marketing association in Texas owned all the stock of the finance corporation. In some of the other States, the cooperative has owned a much smaller amount, whereas the borrowers own the majority. In other cases the cooperative owns none of the stock.

The source of funds used to purchase this stock is ordinarily the reserves of the cooperative, although in 1930 two of the associations borrowed the funds from the Federal Farm Board. It is doubtful whether an association should jeopardize the reserves belonging to its members or its own credit by investing money in the stock of a finance corporation, particularly when such organizations in many cases have proved unprofitable. Moreover, there is a serious question of equity and justice among the members involved. As a rule only a small portion of the members obtain loans, and it is questionable whether the funds belonging to all of the members should be invested and jeopardized for the benefit of only a few. Of course, if the added volume of business acquired through the use of the finance corporation results in reducing the unit costs of operating to a considerable amount, the investment might be profitable for nonborrowers as well as borrowers. But it is probable that such reduction in cost has not occurred from the organization of most of the credit corporations affiliated with the cotton marketing associations.

Several of the cooperative associations have paid the salaries of the corporations' employees, and some have paid all the expenses of their finance corporation. These expenses may be divided into two classes, (1) direct expenses of the corporation and (2) joint

expenses that the cooperative would have anyway such as salaries of their field men, who may give some time to the business of the corporation. There seems to be little question but that the cooperative could well pay the joint expenses of both the organizations since it would have to pay practically that amount for its own purposes. Whether the cooperative should pay the direct expenses of the corporation will depend upon whether the benefits to it are equivalent to the outlay.

Another important question in the matter of affiliation is whether both organizations should be operated under the same management. There are several advantages of close affiliation. The work of the two organizations is closely coordinated for mutual benefits, and there is the advantage of economy in operation. On the other hand, when such an arrangement exists, the members seldom distinguish between the two organizations. Ill feeling caused by the refusal to grant loans or vigorous collection methods is then directed not only against the finance corporation but against the marketing association as well. In fact, such an arrangement may result in the loss of a considerable number of members. Another objection to placing the finance corporation under the same management as the cooperative marketing association is that the executives of that association may jeopardize the interests of the stockholders of the finance corporation in order to increase the membership of their association.

One of the largest expenses of operating both a cooperative and a credit corporation is the cost of maintaining a field force and of paying its traveling expenses. If the field men of the cotton association could satisfactorily take care of the credit work a real savings would result. But the use of the field staff of the association by the corporation has often proved unsatisfactory. Field men are usually salesmen and not credit men. They are generally anxious to make loans in order to get new members and are seldom able, or willing, to judge carefully the applications for loans. During the picking season, when they should be busy signing up new members, their time, if they represent both organizations, is used in checking up on borrowers to see that loans are paid. Thus valuable time is lost from their principal work. Moreover, while enforcing the collection of loans, they are likely to make enemies rather than friends.

It has been thought by some that the best plan is for the corporation to have a small force of field men of its own, and to have the association's field men serve only in an advisory capacity, and as a source of information relative to the credit standing of individuals and to the amount of cotton they have to deliver.

EXCESSIVE HAZARDS OF THE LOANS

One of the chief problems of the agricultural credit corporations that finance cotton production is the hazardous character of the loans. The single-crop system causes the creditor to take an excessive amount of risk. The success of the crop is dependent on the weather conditions, and heavy rains, hail, drought, or floods may practically destroy the whole crop. Furthermore, the crop is subject to boll-weevil and other insect infestation which may also completely destroy it. Last of all the repayment of the loan depends to a large

extent on the price obtained for the crop. In past years when cotton prices have been high, it has often been profitable to plant all the land in cotton and to buy all of the feed and food necessary. This practice has been carried over into years when cotton prices were low and has contributed greatly to the hazards of lending.

Another factor contributing to the hazards of lending to the cotton farmer has been the excessive use of credit. This is largely a result of the single-crop system whereby the farmer devotes his entire time to the production of a cash crop instead of providing a living for himself on the farm. As a consequence it is necessary to buy a large part or all of the provisions, most of which have to be obtained on credit. Periods of high prices for cotton during the World War, and during some years since the war, have made it relatively easy to repay large loans out of the proceeds of the crop, but with low prices of cotton the advances to which farmers were accustomed have proved excessive.

One of the most important causes of the credit difficulties of farmers is the fact that they have accumulated little property. Many farms, after a hundred or more years of cultivation, show nothing in the form of accumulated wealth except a few dilapidated dwellings, a little machinery, and several poorly fed animals. The accumulation of wealth often amounts to far less than the depletion in the fertility of the soil. Although some farmers have made substantial outside investments, many of them have little or nothing more than their farm properties, which often are heavily mortgaged. As these represent most of the accumulated wealth, borrowing must be based largely on wealth yet to be created and loans must be secured primarily by a crop not yet grown; the creditor's participation in the growing of a crop on this basis is but little more than a partnership interest.

If the farmer has accumulated some wealth in the form of livestock, equipment, and land free from mortgage, or investments, he is able to borrow much more easily and at a lower cost. Such a loan is less hazardous to the creditor because it can be secured by existing property and can be liquidated regardless of whether the crop is a success. Moreover, when a loan is based upon sound security, less consideration need be given by the creditor to the borrower's plan of operation. Little or no need will arise for supervising the operations of the borrower or for watching to see that he applies the income from the crop to the debt. As a consequence, the cost of making and servicing the loan will be less, and under competitive conditions, this reduction of cost to the creditor should be reflected in a reduction of charges to the borrower.

It is possible that, should agricultural credit corporations owned by borrowers prove to be successful and stable institutions, they may become a satisfactory place for permanent and extensive investments by farmers. If, instead of requiring the borrower to take stock equal to 10 per cent of his loan the first year only they should require the borrower to take stock equal to 5 or 10 per cent of his loan every year, the farmer would soon acquire a substantial investment. As his investment in the corporation increases, it should become increasingly easier every year for him to obtain the credit needed for farming operations because the margin of safety to the corporation would become greater every year. Ultimately, if he owns stock equal to the

amount of credit he needs to grow his crops he should be able to obtain a loan by merely pledging his stock and giving a mortgage on his crop. Little if any investigation would be needed.

This plan would not only make it easier for the grower to obtain his loan, but it would tend to reduce the costs of the loan to him for the lower cost of operation, and the smaller losses of the corporations should be reflected back to the stockholder. The corporation would gradually accumulate a capital sufficient to make a large portion of its loans out of its own funds. With plenty of capital and plenty of loans to offer as collateral, it could more easily borrow what funds it needed from the Federal intermediate credit bank, and in this way the operation of the corporation would be facilitated.

This plan could be recommended only in case an agricultural credit corporation proved to be a sound, stable institution in which there was little risk of impairment of capital. It would be unwise, at present, to recommend that farmers invest a large part of their savings in these institutions. It is hoped that with the recent increase of 1 per cent in the margin of earnings allowed the corporations, these organizations will become stronger and more substantial. In that event they may be recommended to farmers as a satisfactory place for the investment of accumulated savings.

AN APPRAISAL OF THE CORPORATIONS

An appraisal of the corporations included in this study should include a consideration of three factors: (1) Importance of agricultural credit corporations as a source of farm credit, (2) desirability of state-wide operations, and (3) affiliation with cooperative marketing associations.

AGRICULTURAL CREDIT CORPORATIONS AS A SOURCE OF CREDIT FOR FARMERS

As a source of credit for cotton farmers, the agricultural credit corporations, from some standpoints, compare very favorably with other agencies. If they have the necessary capital, there is practically no limit to the amount of loanable funds which is available through them on good paper. The Federal intermediate credit banks tap an immense reservoir of credit which would not be seriously affected by failure of the cotton crop in one particular State or area.

The case is different for most local lending agencies. Both the local banks and the local credit merchants are adversely affected by poor crops in their territory because they depend to a large extent on local funds for lending purposes. Moreover, in the same years that local funds are at a low level because of a poor crop or poor prices, the credit of these local agencies with large city banks and merchandise companies is restricted. Thus failure of a crop or a poor price results in a scarcity of loanable funds and a restriction on loans the following year not only for farmers whose credit is impaired but for those whose credit is sound. On the other hand, if an agricultural credit corporation can keep its capital from being seriously impaired in a bad year or can increase the capital readily by selling more stock, it has an almost unlimited source of credit available for good paper in the following year.

It has often been contended that agricultural credit corporations are better suited to handle crop-production credit than are commercial banks; that they do not have demand liabilities (deposits) and

consequently are able, without incurring as great risks, to loan on paper of the term of eight or nine months needed for the crop. Certain studies have shown, however, that banks in some areas can satisfactorily carry paper with a term of a year or more in their portfolios.[9] In an area with highly seasonal credit needs, such as the Cotton Belt, the banks probably feel more strain at the peak of the season than do the agricultural credit corporations. At the same time that the loans of the banks are approaching a peak as a result of seasonal requirements for the farming operations of borrowers the depositors are withdrawing their funds for use in their own farming operations. But again, it is difficult to generalize, for many banks in the cotton area are able to borrow from the city correspondents or to rediscount paper with them at the peak of the lending season.

Agricultural credit corporations are probably better prepared to extend credit to farmers than are most merchants. Analyzing credit risks is the principal work of the personnel of the credit corporations, whereas it is often a secondary and incidental task for the merchants. In fact, analysis of the farmers' financial statements and other data are the exceptions and not the rule with the merchants. Their margins are wide, and thus they are not compelled to study so minutely the possibilities of loss. Wide margins for merchants have tended to promote a grouping of risks, whereas narrow margins for the credit corporations have promoted a classification of risks. Furthermore, agricultural credit corporations, through the Federal intermediate credit system, are able to obtain their funds at a lower cost than are merchants, and as a result of that and other factors the cost of credit to farmers through the corporations has been smaller.

The credit corporations included in this study, except in one or two instances, have not furnished a sufficient volume of credit to affect materially the general market rate of interest or other costs of money in their areas. In most cases the operations have covered large areas and have not been concentrated sufficiently to afford real competition for other lending agencies. It is probable, however, that some members of the marketing associations have been able at times to obtain better terms or better rates on loans by threatening to borrow from the credit corporation instead of local credit agencies.

As has been pointed out, one of the principal defects of this system of agricultural credit is the amount of red tape involved in getting loans. Whereas the farmer who borrows from a local bank is often able to obtain a loan immediately upon asking for it, and merely by signing his name, the borrower from the corporation has to prepare a long and detailed application and financial statement, take an oath as to its accuracy before a notary public or other officer, have the records searched for prior liens, sign a half dozen or more papers, record the mortgages, and then wait two or three weeks while the papers take seven or eight trips through the mails. If, on account of his lack of acquaintance with these legal papers which he has occasion to study only once a year, the borrower makes a slight error, the papers are returned to him, causing a further delay of

[9] GARLOCK, F. L. LONG TERM LOANS OF IOWA BANKS. Iowa Agr. Expt. Sta. Research Bul. 129, p. 254–300, illus. 1930.

several days or a week. Meanwhile the season advances while he waits for the credit to buy his fertilizer.

Some improvement has resulted from the change of the law in 1930 which permits the Federal intermediate credit banks to lend directly to the agricultural credit corporations on the security of farmers' notes as an alternative to rediscounting the notes themselves. Correction of minor errors in the papers creates less delay in the advancing of credit by the banks for other collateral can be substituted during the interim period. This provision adds some of the much-needed flexibility to the system.

Some persons have felt that the agricultural credit corporations have not served farmers as they should because of the high standard for loans set by the Federal intermediate credit banks. It has been said that the only persons who could get loans from the intermediate credit banks through the corporations were those who could get loans from any local bank. The implication is that the intermediate credit banks were formed to lend on a poorer class of paper than commercial banks ordinarily will accept. There is nothing in the act which created the Federal intermediate credit banks that indicates this.

The banks were created to fill a need for credit of a term shorter than the usual mortgage loans on land and longer than the customary commercial bank loans. Maximum and minimum terms of three years and six months, respectively, were set. Experience has failed to demonstrate, however, that loans of maximum term were satisfactory or needed; consequently the loans of the system have been largely from six months to one year with an extension often granted in the case of livestock loans if the security justified it. In 1930, the lower limit of six months was removed. Modeled somewhat after the War Finance Corporation, the system was intended also to supplement commercial banks wherever necessary. This it is doing at present in some regions where banking resources are insufficient to meet the needs of agriculture; in regions where banking resources are ample this type of farm credit has not been used to a great extent. The act, however, contains no implications that the system was set up to handle loans that commercial banks could not carry on account of the risk involved.

Whether the local banks or the agricultural credit corporations get the better paper is a moot question. Obviously, no one answer could cover the situation for all local banks and all corporations. In a region where local bank facilities are ample and interest rates are reasonable the tendency would probably be for the corporations and Federal intermediate credit banks to get the poorer paper. Prosperous farmers maintain business relations with their banks, and if they can get loans at reasonable rates from the banks they will not be inclined to borrow from the credit corporations through which it is much less convenient to obtain loans. Moreover, bankers have a personal acquaintance with their customers, and they will attempt to keep for the bank those loans that are the least hazardous even if they have to make some concessions in interest charges. Those whom the banks will not accommodate will seek loans from the credit corporation. On the other hand prosperous economical farmers will often seek loans through credit corporations if the costs are lower than from the banks. Again in some cases the local banks can not make loans large enough to accommodate large operators.

Some maintain that the agricultural credit corporations get the "best risks" because the Federal intermediate credit banks set up rigid requirements for loans and only the very best paper is taken regardless of the needs of the farmers. The local banks must take the remainder. It is logical to conclude, however, that neither type of institution has a monopoly on the best paper to the exclusion of the other.

STATE-WIDE OPERATIONS

Both advantages and disadvantages are to be found in State-wide operation of agricultural credit corporations. The corporation operating over a whole State is able to obtain a wider diversification of risks than one whose territory is more restricted. Rain, hail, flood, droughts, and insect infestation are not likely to affect so large a portion of the loans of a corporation operating over a whole State as they would of a corporation operating in the retail trade territory of a single city or town. In addition, the State corporation is able to obtain a large enough volume of business to hire full-time employees and capable management.

On the other hand there are counterbalancing advantages for the local agencies. By being personally acquainted with the borrower and having a knowledge of his farm, officers of local agencies are better able to judge the probable yield of the crops, the value of the security, the ability of the farmer, and his personality and character. Moreover, they are in a position to keep a constant watch on the progress of the crop. The agricultural credit corporation operating over a whole State finds it much more difficult to obtain this information. It must depend on the statements of local persons for a knowledge of the personal characteristics of the borrower and sometimes for a knowledge of his farm and operations; such information is not always reliable because local persons may be anxious to have the loan made. Then, too, the corporation must send its field men long distances to visit the farm, possibly to appraise the security before making the loan, to watch the progress of the crop during the summer, and to prevent illegal sale of the cotton during the picking season. This is expensive and not so satisfactory as local supervision, although it is sometimes claimed that the field men of the corporation devoting their full time to the work often know the condition of loans and security better than do the officials of many of the local lending agencies.

Another advantage of the local lending agency is that an unreliable borrower is more inclined to pay local debts than debts to an outside corporation for he does not wish to lose his credit in the community. In fact it is sometimes hard for an outside corporation to secure judgment against a man in his own community before a jury of his neighbors.

The plan of having local unincorporated groups pass upon the paper submitted and guarantee that paper to the extent of their stock in the State credit corporation is a worthy attempt to obtain the volume of business and diversification of risks which go with a State corporation while at the same time obtaining many of the benefits of local organizations.

An experiment not yet tried is that of the cooperative marketing association having a number of affiliated local credit corporations

scattered throughout the State. There is serious doubt whether the volume of production credit needed for members of the cooperative would be sufficient in local areas to support the activities of such corporations. The plan might be possible, however, if these corporations did not confine their activities exclusively to members of the marketing association.

RELATIONS WITH COOPERATIVE MARKETING ASSOCIATIONS

In studying the relationships between the credit corporations and the cotton associations one should have in mind the conditions which led to the organization of the subsidiary or affiliated finance corporations, changes that have occurred in the conditions since their organization, and subsequently revised concepts of the function of the subsidiaries. It should be recalled that association members were thought to be hampered in the delivery of their cotton to the cooperatives by the control exercised over them by their creditors. The corporations were set up largely to remedy this situation although it was also expected that they would attract new members to the marketing associations and would render the members a much-needed financial service.

The situation has changed materially during recent years. Loans made to the cooperative associations by the Federal Farm Board in 1929 and 1930, enabling them to advance the farmer approximately 90 per cent of the market value of the cotton at the time of delivery, have made it possible for more farmers to liquidate their indebtedness on the crop out of the association's advance than could have done so in previous years. Since borrowers could pay their debts out of the association's advance the creditors have had little grounds for objection to marketing through the cooperative. Moreover, if the value of the cotton produced has been insufficient to liquidate the debt, the creditors have often been willing to take 90 per cent of current market value in part liquidation with the chances of recovering more than the extra 10 per cent if prices advanced while the cotton was held by the cooperative association.

Another factor that has changed the situation in late years has been the scarcity of loanable funds of local credit agencies. In many cases local agencies have been unable to provide the amount of credit needed in the community and have been glad to have some of the farmers obtain funds through the Federal intermediate credit system. This condition has tended to break down the opposition to the cooperative program.

At the same time the shortage of credit supplied by other agencies has made the granting of production credit by the associations or their subsidiaries a more needed service for members. Whereas, in the past, the chief purpose of the corporations was to enable members to make deliveries of cotton by throwing off the control of other creditors, the chief purpose to-day is to render a needed financial service to members.

The extent to which the agricultural credit corporations have aided the marketing associations to obtain cotton is unknown and can not be accurately measured. Figure 10 shows for comparative purposes the trend of deliveries of 12 cooperative cotton marketing associations and the trend of loans of their 11 affiliated agricultural

credit corporations. In order to eliminate the fluctuations in trend due to the size of the crop the deliveries have been adjusted for yearly variations in production by States. A comparison of the trend of deliveries (adjusted) with the volume of loans indicates very little relation. In fact, the trends are in opposite directions about as often as they are in the same direction. Three similar analyses of individual associations and their credit corporations show results comparable to the results of the above comparison for 12 associations combined. It would appear therefore that other factors were of far greater importance than the amount of production credit extended in determining the volume of deliveries.

The termination of the original 5-year contracts is easily discernible in the deliveries for 1926, 1927, and 1928, and the influence of the Federal Farm Board is to be noticed in their upward trend

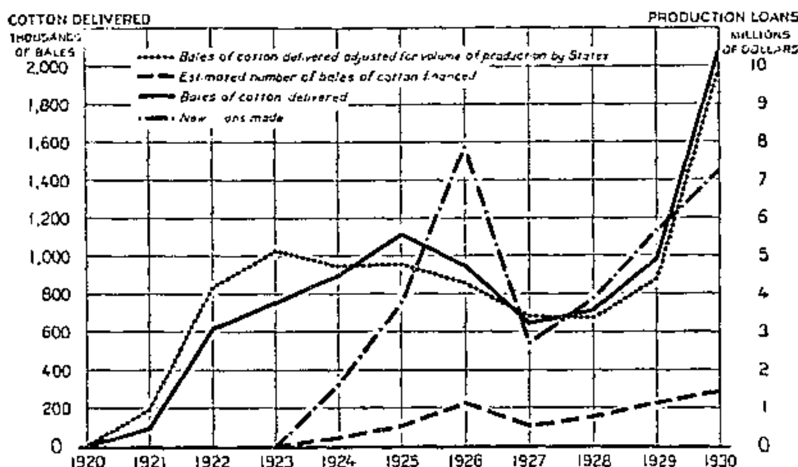

FIGURE 10.—DELIVERIES OF COTTON TO 12 COOPERATIVE MARKETING ASSOCIATIONS AND THE VOLUME OF NEW PRODUCTION LOANS MADE YEARLY BY THEIR 11 AFFILIATED CREDIT CORPORATIONS

The trends of the loan curve and the delivery curves show little relationship between the two. Moreover, a comparison of the deliveries and the estimated number of bales financed indicates that production credit is a minor factor in determining the amount of cotton delivered.

in 1929 and 1930. The estimated baleage financed by the corporations represents only a relatively small portion of the total cotton handled and supports the conclusion stated above that the financing of production is only a minor factor in obtaining deliveries.

Furthermore, it must not be assumed that all of the cotton obtained from borrowers would not have been delivered to the associations unless it had been financed. Many borrowers were members of the marketing associations in years before they obtained loans of the credit corporations, and undoubtedly many would market their cotton through the associations regardless of whether they obtained credit from the affiliated corporation.

On the other hand it is doubtful whether a comparison of deliveries and loans reflects the full influence of subsidiary or affiliated credit corporations in obtaining cotton for the associations. The very existence of a credit corporation whose services are available to members is a strong bargaining point for the member in his rela-

tions with his creditors. It is entirely possible that the deliveries obtained by making at least some of the members more free from the dictates of their creditors have been larger than the amount of cotton financed.

The management of one of the cooperative marketing associations feels that the finance corporation has an indirect value for the marketing association in that the delivery of mortgaged cotton starts the flow of cotton to the cooperative early in the fall. The shipment of that cotton provides the farmers of the State with concrete evidence that others think it worth while to market their cotton through the cooperative association.

But the activities of the finance corporations have resulted in losses, as well as gains, in membership. Creditors are popular when loans are being made but very unpopular at collection time. Rigid measures necessary to enforce collection result in a loss of some of the good will gained by granting the loan. This is especially true in years when there are poor crops. Discontent is caused by refusal to grant loans that are not sound. It has often been necessary to refuse many more loans than could be granted, and such a situation requires delicate treatment to prevent the loss of members.

The activities of the credit corporations have often been hampered by the policies of the marketing associations. These finance corporations have not been free to go out and get the type of business they have wanted and needed. They have been required to wait for business to come to them and have been restrained from soliciting it because the competition with local credit agencies thus created might make enemies for the cotton associations among the bankers and business men. The credit corporations have been permitted to make loans only to association members and have been unable to refuse a loan to any member because of it being too small to be profitable. As a consequence of these handicaps the size of loans has been small, the volume has been restricted, and the loans have been scattered over a wide area. These conditions have resulted in restricted incomes and excessive expenses, in some cases bringing about an impairment of the capital.

CONCLUSIONS

Conclusions regarding the corporations included in this study and any suggestions for future policy will depend on the point of view taken as to their fundamental purpose. Are these corporations to be judged on the basis of their own showing as agricultural credit institutions or as a part of the cooperative marketing movement? Furthermore, to render the greatest service to all concerned should they continue to be affiliated with the marketing associations?

As financial institutions purely, their record, with few exceptions, has been disappointing. They have financed in all but one case only a very small portion of the farmers in their area—almost a negligible portion—although the business which they have done in those communities where banks have failed was undoubtedly a real help. In 1930, the combined volume of business was the highest of any year, but that was largely due to the rapid expansion of one of the most successful corporations, its business representing more than 60 per cent of the total. Many of those corporations that contributed to the large total volume of business in 1926 were out of business

or in liquidation by 1930. Half of the corporations that have been organized have failed or have voluntarily gone out of business, and in 1931 only a few of them were agressively going forward. In passing judgment on them, however, it should be kept in mind that farm credit agencies of other kinds have failed in large numbers during the same years.

There have been a number of causes of failure, chief among which have been: (1) Large losses on loans due to low prices of cotton, to the single-crop type of farming, resulting in excessive borrowing and excessive hazards, and to the lack of sufficient reserves of the borrowers, resulting in the security being often limited to a crop lien; (2) limitations of earnings, due both to legal limitations on interest charges and to the seasonal character of the business, so that the accumulation of reserves sufficient to meet the losses has been very difficult; (3) relatively high costs of operation, due to the small size and scattered location of the loans; (4) inefficient management in some instances; and (5) the practice in the early years of granting doubtful loans in order to induce farmers to join the marketing associations. The immediate cause for discontinuance of operations by three of the corporations has been the inability to get credit from the Federal intermediate credit banks as a result of the impairment of capital from an accumulation of uncollectible or frozen loans. Three others discontinued operations after a small experiment of a year or two had disclosed the difficulties of furnishing production credit. Two of the corporations went out of business because the parent organization failed.

In addition to making an unimpressive showing as financing institutions, the corporations usually have failed to give substantial aid to the marketing associations. Estimates of the number of bales of cotton financed by all corporations have at no time placed them in excess of one-fourth of the total deliveries, and in the case of some corporations the portion of deliveries obtained by financing the crop has been negligible. Moreover, the volume of financing does not appear to have borne a close relationship to the volume of cotton delivered. (Fig. 10.) Nevertheless, some of the corporations have cost the parent associations substantial sums in the way of expenses of operation, the sacrifice of income on investments in their capital stock, and losses in the value of that stock.

The case for agricultural credit corporations rests to-day not upon the needs of the cotton cooperative marketing associations for a financial subsidiary but upon the needs of farmers for credit. Although a number of the corporations have failed and most of them have proven relatively ineffective as a means of building up the marketing associations, it can not be gainsaid that they have rendered a real service to the members who have obtained loans. It is to be regretted that the service has been limited to such a small proportion of the farmers who needed it and that the cost to the cooperative or the other stockholders has been so high.

The adoption of certain new policies might help to remedy the situation, although financing the production of cotton at present prices is an extremely difficult task. Despite the fact that several corporations are operating successfully while financing only association members, it is believed that many of the corporations would be strengthened and a greater service would be rendered to the

farmers of the States if their services were not confined to members of the marketing associations, if they were not obligated to serve all members of the associations alike, and if they were free to solicit loans. Their services would thus be available to five or six times as many farmers. Having a larger group to serve and being free to make loans to nonmembers, they could obtain a larger volume of business and thus operate at lower unit costs. They could also concentrate their activities in certain areas through making loans in those areas and refusing scattered applicants in others. By soliciting large, safe loans and refusing the extremely small, unprofitable ones they could operate much more successfully.

Were this extra freedom of action to result in stronger credit corporations, the cotton associations and their members would benefit by extending the services to nonmembers. The marketing associations, it is true, would lose the business of those borrowers who market their cotton through the associations merely to get the financing service, but, on the other hand, they would not have to contribute so much to the support of the corporations. The membership of the associations might not be willing to extend the benefits of their organization to nonmembers; in such event the only way to obtain the freedom of action desired would be to have separate and distinct credit institutions.

The organization of independent corporations raises certain other problems. Who will promote them? Who will finance them? Even if the borrowers are required to buy stock it can not be expected that the cooperative marketing associations will provide the original capital as they did for many of their subsidiaries. Would it be possible and desirable to obtain funds from bankers and business men and, if so, would these men control the corporation or would it be primarily a farmers' cooperative enterprise controlled by farmers?

It is entirely possible that in certain cases cooperative financing may render as great a service to farmers as cooperative marketing. The marketing associations could well lend a helping hand or even take the initiative in sponsoring the movement for farmers. With their mailing lists, their field staffs, and their wide contacts, they are in an excellent position to aid groups of farmers who would like to have a cooperative credit institution for financing the production of their crops. The two farmers' organizations could aid each other. The finance cooperative would obtain the advantage of collecting its loans through the marketing association. The marketing association by sponsoring such a corporation would be rendering a service to its members who needed a new source of financing. Under this plan no part of the cost of financing crops of others would fall upon those members of the marketing association who did not care for or could not qualify for loans from the corporation.

APPENDIX

CONTRACT BETWEEN GROWERS AGRICULTURAL CREDIT CORPORATION AND MEMBERS OF LOCAL GROUPS

THIS AGREEMENT, made on this ____ day of __________, 193__, by and between those persons who are or do become members of that certain organization known as ____ Credit Group, parties of the first part, and Growers Agricultural Credit Corporation, a corporation chartered and existing under and by virtue of the laws of the State of North Carolina, with its principal office in Wake County, North Carolina, party of the second part, WITNESSETH:

WHEREAS the party of the second part is engaged in the business of extending agricultural credits; Whereas the parties of the first part contemplate applying to the party of the second part to obtain loans for agricultural purposes; and WHEREAS the parties of the first part desire to secure in a measure the party of the second part against losses resulting from any loans made to member of the aforesaid Credit Group.

Now, THEREFORE, for and in consideration of the premises, and for the sum of $1.00, paid to the parties of the first part by the party of the second part, the receipt whereof is hereby acknowledged, the parties of the first part make and enter into the following agreements and promises:

1. That the parties of the first part will exercise due diligence in submitting to the party of the second part applications for loans only in behalf of persons worthy of the credit requested, in seeing that all applications, financial statements, and other loan papers submitted by them are correctly and fully filled out and in helping to collect on or before date of maturity all loans made to the parties of the first part.

2. That ______________ has been selected to serve as Chairman of this Credit Group; ______________ has been selected to serve as Secretary of this Credit Group; the following persons have been selected to serve as Executive and Loan Committee for this Credit Group; said Committee to consist of not less than three persons and not more than five persons, it being permissible for either Chairman or Secretary, or both, to be members of said Committee:

______________________________, ______________________________,

______________________________, ______________________________

______________________________.

3. The Chairman and Secretary of said Credit Group shall serve for a period of one year and until their successors are selected and qualified; in case of vacancy the Executive and Loan Committee shall have authority to select a new Chairman or new Secretary; the members of the Executive and Loan Committee shall serve for a period of one year and until their successors are selected and qualified; in case of vacancies, the remaining members of said Committee shall have authority to fill same; the Chairman and Secretary acting jointly can call a meeting of the members of the aforesaid Credit Group, either on some date in January of each year, or at any other time that they might deem said meeting desirable or at any other time that said meeting might be requested by written petition of one-half of the members of said Credit Group.

4. That all applications for loans for members of said Credit Group must be approved in writing by at least three members of the Executive and Loan Committee; all notes submitted for members of said Credit Group shall bear some signature, stamp, or other appropriate writing, to be made by the Secretary, to identify said notes as coming from the aforesaid Credit Group; and it is distinctly understood that in submitting and handling applications for loans, in handling proceeds of notes and in all other matters relating to loans, the Chairman, Secretary, and Executive and Loan Committee will be acting as the agent of each individual borrower and not in any sense or in any respect as the agent of the party of the second part.

5. That the signing of this Agreement by the aforesaid persons designated as Chairman and Secretary shall bind and make parties to this contract all members of the aforesaid Credit Group and all persons who at any time might obtain loans through this Credit Group; the procurement of a loan through this Credit Group by any person shall make that person a member of this Credit Group and shall constitute on the part of said person approval and ratification of the provisions of this Agreement; and, though many members of said Credit Group might sign this instrument as evidence of their having actual notice of the provisions hereof and as personal commitment thereto, failure on the part of any person to sign this instrument shall not relieve said person of any obligation hereunder provided said person applies for and obtains a loan through this Credit Group.

6. That the capital stock in the party of the second part owned by members of the aforesaid Credit Group is hereby assigned, pledged and transferred to the party of the second part, its assigns and successors, as collateral security for the payment of all notes signed by members of said Credit Group. This

assignment and pledge of capital stock includes all stock that has already been purchased and all stock that might in the future be purchased by members of said Credit Group. In case of any certificates of stock that have already been issued or that might in the future be issued to members of said Credit Group, they appoint and constitute the Secretary of the party of the second part as true and lawful attorney in fact to execute the proper assignment of said stock certificates, hereby giving to said party full power and authority to assign and transfer said stock certificates, in accordance with the foregoing provisions, hereby ratifying and confirming all acts and deeds done by the said attorney in fact just as if same had been done by each of the parties of the first part personally and acting for himself.

7. If on the 15th day of December of each year, the party of the second part holds any uncollected notes signed by members of the aforesaid Credit Group, or if the party of the second part has suffered any losses or incurred any expense for attorney's fees or other efforts to collect the notes of any of the members of said Credit Group, said party of the second part may, at any time after said date, sell the aforesaid stock of all the members of said Credit Group, proceeds of said sale to be applied towards the payment of said uncollected notes and/or the said losses and said expenses incurred in connection with the notes of the members of said Credit Group provided said sale be made in the following manner: Before said notes and stock shall be advertised for sale, the party of the second part shall direct a communication in writing to either the Chairman or the Secretary of the aforesaid Credit Group, advising him of the existence of uncollected notes and/or losses in connection with notes of the members of said Credit Group; if either the said Credit Group, its members, or other persons do not, within ten days from the mailing of said communication, liquidate said uncollected notes and pay said losses, the party of the second part, its assigns or successors, may sell all of said uncollected notes and all of the stock in the Credit Corporation owned by members of the aforesaid Credit Group, at public auction for cash at the Court House door in Raleigh, North Carolina, after giving notice of said sale by posting a notice of same at the Court House door and three other public places in Wake County and by mailing a copy of said notice to the last known address of the owner of any stock certificate that is to be included in said sale; provided that, if the party of the second part elects to do so, it may sell, first, the stock of the members, who have not paid their notes or the collection of whose notes caused loss to the party of the second part because of attorney's fees or other expense; but the election of this option is not compulsory and shall not affect the rights and remedies of the party of the second part as hereinabove provided in this paragraph.

8. Certificates representing stock in the party of the second part, now owned or subsequently purchased by any member of the aforesaid Credit Group, shall be deposited with the President of the party of the second part as custodian of said stock; and an appropriate paper writing shall be furnished to each owner of said stock to evidence the aforesaid deposit on same.

9. If any member of the aforesaid Credit Group wishes to withdraw from said Group, he may do so by expressing in writing his desire to the Secretary of the Group and to the party of the second part, provided, however, that no member of the aforesaid Credit Group can withdraw therefrom at any time when the party of the second part holds an uncollected note signed by any member of said Group, unless said member desiring to withdraw shall execute a paper writing transferring and setting over to the party of the second part all right, title, and interest that said withdrawing member might own in any certificate of stock in the party of the second part.

In Witness Whereof, the parties of the first part subscribe their names hereto on the dates indicated opposite each name:

Name	Address	Date of Signature
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U. S. GOVERNMENT PRINTING OFFICE: 1932

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