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## SOME THOUGHTS ON THE FARM CREDIT SUPPLY\*

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*Rural Bank of N.S.W.*

The purpose of this paper is to consider some aspects of the problems of the farm credit supply. It is not intended to be exhaustive in its treatment of a very wide subject that has already been discussed so frequently. It is felt, however, that the recent emphasis on development (rural and other) justifies another look at the subject, especially in relation to some modifications in the approach to farm credit and the facilities for its supply.

Sir John Crawford has said that discussion of the subject of rural credit "easily lends itself to emotion". I shall endeavour to avoid this pitfall. At the outset I would suggest that, for a subject so significant as the supply of farm credit in the Australian economy, the extent of our study of it in a detailed and objective fashion has been meagre; similarly, the factual material available for this study is, in the main, noteworthy for its generality and scrappiness.

### *The Nature of Farm Credit:*

Access to capital, either owned or borrowed, is an essential prerequisite of modern productive activity, whether on the farm, in industry or commerce. Like their counterparts in industry and commerce, farmers rarely command from their own resources all the capital they need. Other sources of capital are required and for this purpose the services of a wide variety of suppliers of farm credit have developed, either naturally or as a result of some positive group or State action.

A system of credit geared to the requirements of commerce and industry is not, without some modification, necessarily well suited to the needs of financing farming. Farm credit needs to be adapted to the peculiarities of farming. Loans are made for longer periods than in commerce or industry; the term of farm loans must be flexible, and all such loans should have a repayment plan consistent with income.

It is probable that the capital requirements of Australian farming and the demand for credit to meet these requirements will show a relatively high and increasing volume for some time to come. Farming in Australia, in contrast to the situation in older, longer settled countries

\* Presidential address, Eighth Annual Conference of the Australian Agricultural Economics Society, Canberra, February 1964.

has not long emerged from the primary developmental stage; many farms are still being developed; many are frequently changing hands. Thus the demand for farm credit is relatively higher than in older settled countries where farm ownership is less subject to change and a good proportion of the capital is already owned by the farmers themselves.

It is usual to endeavour to distinguish between three major types of farming capital (and credit) requirements:—

- *Long term capital*—land and improvements such as clearing, fencing, water supply, buildings.
- *Medium term capital*—implements, machinery and livestock.
- *Short term (working) capital*—for the production process (wages, fertilizer, seed, fuel, etc.).

This breakdown has some significance in the study of the individual farm programme and its credit needs. For lack of adequate data, however, it serves little practical purpose in the study of the supply of credit for Australian farming.

However, as the demand for farm credit arises from the need for capital, it follows that any system for the provision of credit for farming needs to serve a wide variety of purposes. There are demands for fixed or long-term loans, for loans for intermediate periods and for loans for short periods. The needs of borrowers will vary widely, and will require a variety of means depending upon the case and the circumstance. The type of security available, the degree of risk involved, the location of the enterprise and the nature of its operations in production and marketing are all variable factors which require varying arrangements.

#### *The Sources of Farm Credit:*

Thus, in Australia, as in most other countries, farm credit is supplied from a variety of sources—the trading banks, pastoral finance companies, insurance and trustee companies, government banks and various government agencies, and a variety of private lenders. Looking back over the history of farming in Australia, it is not surprising to find that the sources of farm credit, and the terms and conditions under which this credit has been supplied have undergone significant changes.

These changes have been a reflection of the status of farming in the economy, the economic situation and environment. A study of these changes over time provides abundant evidence of the adaptation and modification of credit sources and services to meet the changing needs and circumstances of a basic industry in a growing economy. It has always been popular to consider our increasing sophistication, at least in the economic sense, and to conclude that our techniques and machinery of financial services and management have displayed a capacity to adapt themselves to the changing needs of farming and the farming environment.

However, we find on reflection that these adaptations or modifications of the farm credit supply system, or many of them, have not, by any means, been automatic. The pressure of economic, social, and political circumstances in the 1930's for example, made Government intervention unavoidable, to effect both short term and more permanent changes in some elements of the farm credit supply. It would be un-

reasonable to have expected that these institutional and related changes in the source, conditions and supply of farm credit should have occurred unaided, as a process of automatic adaptation to radically and quickly changed circumstances. In fact, it would seem that automatic adaptation or modification of existing procedures to any significant extent has rarely occurred in the absence of some positive external pressure or action.

To a marked degree, the development of Australian farming has taken place, at the most significant points of time, under the close influence of Government policies. These policies have been especially influential in the land settlement fields, where most of the basic features of initial farm size, production programmes, initial development, settler selection, have been more or less officially determined and prescribed, and where government financing of the settlement schemes and the settlers has been an essential element.

Closer settlement activities before World War I, soldier settlement after World War I, debt adjustment, marginal area reconstruction and other special assistance schemes during the 1930's, the multitude of adjustments during World War II (including the proliferation of schemes for subsidies, price guarantees, marketing schemes, etc.), soldier settlement after World War II and more recent civilian land settlement schemes, all substantiate the suggestion that governments have participated widely and deeply in both innovations and modifications of what might be termed the free market for farm credit. They also point to the conclusion that with governments so heavily involved in the determination of farm settlement policy, especially in the sense of farm establishment and promotion, there has been an inescapable need for governments to initiate action affecting the supply of farm credit.

At the same time, it would seem reasonable to conclude that to the extent that governments have intervened or taken the initiative to promote national development, whether it be in land settlement or industrial and commercial expansion, their intervention to supplement existing farm credit services or supply, or to exert some positive influence on them, is neither unexpected nor inappropriate. In fact, a study of farm credit services available in most countries indicates that, in the interests of farm development along lines consistent with the aims of national policy, some degree of government intervention has occurred.

It is not appropriate here, in terms of time available, and for other reasons, to embark upon a more detailed study of the justifications and consequences of government action in the field of farm credit. It is sufficient to suggest that, accepting the view that the supply of farm credit is a matter appropriate to government review and action within the bounds of its constitutional powers and national responsibilities, the farm credit situation warrants constant and detailed study.

The particular experience of the farming sector in the twenties and thirties gave new impetus to the study of the problem. This was, in many respects, reinforced by the wider interest in the current and future problems of the farming sector which came in World War II, and is highlighted in the reports of the Commonwealth Rural Reconstruction Commission. (Sight must not be lost, too, of the views expressed by the Banking Commission in the thirties, and its proposals for establishing a Mortgage Bank).

The following paragraph, from an official Commonwealth statement issued in 1946, gives an indication of the basic approach of Federal policy makers to the rural credit problems at the end of World War II:—

“The Rural Reconstruction Commission has drawn attention to the way in which farmers have been handicapped in their endeavours to adopt improved farming practices by inability to obtain finance on satisfactory terms.

The Rural Reconstruction Commission has also emphasised the great need for more effective measures of reconstruction and rehabilitation of those farm units which are at present financially and economically sound, and for the more effective co-ordination of these measures with the provision of ordinary banking facilities.

The Commonwealth Government recognises the strength of the criticisms made by the Commission of the existing rural credit facilities and also the force of its recommendation for the integration of those facilities with the measures for financial reconstruction and rehabilitation. The Government has already established the Mortgage Bank Department of the Commonwealth Bank. This Department is already carrying out its function of filling a particular gap in rural credit facilities pointed out by the Banking Commission and it is at present providing facilities for fixed and long-term lending which give the borrower a constant interest rate and security against the calling up of his loan, or the possibility of having to make a large reduction in it, at a time when he is least able to do so.

It is the firm intention of the Government to take further steps to ensure that adequate credit facilities are available to farmers so that they can obtain their various requirements whether for seasonal needs, further development of their holdings, adoption of improved practices or for financial reconstruction. The Government also proposes to seek greater co-ordination of rural credit facilities generally, including those special measures for financial reconstruction and rehabilitation.

Many aspects of this problem fall, of course, within the province of the State Governments and the objectives which the Commonwealth Government believes should be pursued can only be fully realized by effective co-operation and joint action on the part of both Commonwealth and State Governments. The Commonwealth Government therefore intends to inaugurate early discussions with the States on the subject”.

However, there was little in the way of public reports or innovations in the following 15 years to suggest that these “firm intentions” were translated into action programmes.

In fact, six years later (in 1952) Sir John Crawford stated that “one of the most serious problems, *judging by Departmental correspondence*, is credit for development . . . . credit must frankly be put down as one policy problem not yet satisfactorily solved”.<sup>1</sup>

Over the last two decades, the indebtedness of farmers to various credit suppliers has increased substantially. Figures available for farmers’ indebtedness to the major sources of farm credit (the major trading banks, the Development Bank, assurance companies, pastoral finance companies, government land settlement and other instrumentalities, including State banks) show an increase from about £200 million at the end of the 1940’s to over £500 million at present. In other words, the amount of farm debt to these selected, major lenders has increased 2½ times in amount and, in a relative sense, from about 33 per cent to about 40 per cent of the gross value of farm production, or from 60 per cent to about 100 per cent of estimated annual farm income.

There is some evidence in those figures that the credit needs of farming as a whole have been increasing. Whether, and at what rate they will

<sup>1</sup> Sir John Crawford, *Australian Agricultural Policy*, Joseph Fisher Lecture, University of Adelaide, 1952.

continue to do so, is a subject that requires extensive study before any useful conclusions can be stated. It might be stated, however, that if the conclusion that capital formation in farming is largely financed internally from gross farm income rather than from external capital or credit is accepted, the economic circumstances of the farming industries (e.g. the situation and trend of the farm prices received-paid ratio and its influence on the level and rate of internally generated savings and investment) have a significant bearing on the demand for external borrowings. This comment, so far as it relates to total farm credit demand (and supply), may require qualification in respect of short and medium term credit (e.g. production credit) needs, and also to the extent that the number of farms is expected to increase, remain relatively stable, or decline.

Farm credit provided by the trading banks is the most important single component of the total supply. Advances outstanding to rural borrowers from the major trading banks increased from about £110 million in 1949 to £250 million in 1963. These amounts represent, in each case, about one-half of the total identifiable farm debt. As a percentage of total trading bank advances outstanding to all borrowers, advances outstanding to farmers in July, 1963, were about 28 per cent of all "business" advances and just over 22 per cent of total outstanding. In each case, the share of rural advances has tended to decline since 1948, when these figures were first published on a reasonably comparable basis.

It is, of course, not unreasonable to expect that farming's share of total trading bank investment in loans should have tended to decline with the growth of other sectors of the economy, the opportunities for profitable and productive investment which these other sectors offer, and the desire to maintain a reasonable diversification of business and spread of risks. It is emphasized, however, that discussion of this question cannot be conclusive—published information of the participation of banks in farm credit is not as complete as some might wish—details of advances outstanding at various points of time do not tell the complete story so far as the pattern of bank lending activities is concerned.

However, bearing in mind the proviso stated above, it is interesting to observe that, of the major trading banks' total income-earning investments, the proportion represented by loans outstanding has increased significantly, from 46 per cent in 1949/50 to 59 per cent in 1959/60 and 61 per cent in 1962/63. Over this same period, the proportion represented by farm loans outstanding has also shown an increase, from 11 per cent to 13 per cent of the total. It might be concluded from this that the major trading banks have, in their overall investment plans, devoted a rather larger share to farm loans in recent years than they were at the end of the 1940's.

There could, of course, be a number of explanations for this, not excepting the suggestion that rural lending is, in terms of the return on investment, not necessarily unremunerative. It is clear, though not capable of precise measurement, that a significant proportion of the banks' investment in farm loans is of a longer term nature than the overdraft system of lending would imply. If this proportion is, as has been suggested in some quarters, in the vicinity of 30 to 40 per cent of

the total, this could operate to maintain a relatively high level of outstandings.

It is well known, too, that the farm sector is responsible for a major (though declining) proportion of the trading banks' deposit funds (25 per cent in June, 1957; 19 per cent in June, 1963) and this in itself could be thought to warrant a continued high level of participation in farm lending. Whatever reasons can be deduced from the available data, it remains true that the trading banks remain the major source of farm credit funds. While, as has been suggested, it may be thought that the traditional overdraft (short term) lending technique that has proved most appropriate to the nature of the loanable funds available to banks is not wholly suited to meeting all the credit needs of farmers, long experience has produced the means whereby banks have been able to maintain a generally acceptable farm credit service.

*Recent Changes:*

Two significant changes have been effected during the 1960's in the supply of farm credit through the banking system. One is the formation of the Commonwealth Development Bank in 1960, and the other is the introduction of the Term Lending arrangements by the major trading banks.

The establishment of the Development Bank was, basically, an amalgamation of the former Mortgage Bank and Industrial Finance Departments of the Commonwealth Bank, with an enlargement of its capital resources. Since its formation, the original capital fund of £11 million has been increased on four occasions, by £5 million each time, to the present total of £31 million.

Two significant features of the functions of the Development Bank are:—

- (a) That it is to provide finance to assist primary production or to establish or develop industrial undertakings, particularly small undertakings, in cases where, in its opinion, finance is desirable but would not otherwise be available on reasonable and suitable terms and conditions.
- (b) That, when determining whether or not to make a loan, regard is had primarily to the prospects of the borrower's operations being successful rather than to the amount of security the borrower can provide in support of the loan.

This bank is essentially a source of development finance, and is intended to supplement trading bank and other ordinary commercial sources of finance.

It has been apparent, from the volume of applications for loans received, that there has been a substantial demand for this service; and from the volume of loans approved, that there has been a substantial number of suitable propositions that might otherwise have gone unaided. It is also apparent that the bulk of the applications received, and the loans approved, have been in the field of farm development. At 30th June, 1963, rural loans outstanding totalled £22.5 million, as against industrial loans outstanding of £10.4 million. During 1962/63, 1,537 rural loans for £6.3 million were approved, compared with 181 industrial loans for just under £3 million.

*Term Loans—Major Trading Banks:*

Early in 1962, in the course of discussions between representatives of the Australian trading banks and the Government, the banks expressed their belief "that they both could and should play a wider and more constructive part in the growth of our country and the expansion of its trade abroad". At the same time they said that they felt that they were being denied a chance to develop their facilities as they wished by certain features of the arrangements currently in force to control interest rates, the volume of credit and the investment of their funds.

The Government acknowledged its awareness of a growing need for a new type of bank lending to meet developmental requirements, especially of rural industry. Such lending would have to be for moderately long terms and also for fixed terms, and in the Government's view neither of these requirements was adequately served by the overdraft system which had hitherto been the typical and predominant form of bank finance in Australia.

However, the banks indicated to the Government that if they were to carry longer fixed term finance in either the domestic or the export field, they would need to be assured of having the necessary liquid resources for doing so. It would be a different class of business from their ordinary overdraft lending where their funds can be turned over within relatively short periods.

*Arrangements:*

To provide a body of resources on which the trading banks could operate in these new fields, a special Term Lending Fund was established with the Reserve Bank. This Fund comprised accounts held with the Reserve Bank by the trading banks. These were to amount to 3% of each bank's deposits (1% provided from the existing liquid assets and government securities of the banks and 2% transferred from the S.R.D. Accounts). These new accounts represented revolving funds for term lending purposes (total about £57 million).

The purpose of establishing this Fund was to permit the new lending facilities to be developed steadily over the next few years in accordance with current credit policy. The unused part of each bank's account would earn interest initially at a rate of 3½% per annum. (At the same time, it was agreed between the Reserve Bank and trading banks that the convention regarding the minimum ratio of liquid assets and government securities of each bank to deposits, which had been in force for some years, was to be raised from 16 to 18%).

The scope of term lending envisaged that term loans would not be made for consumption expenditure, but for capital expenditure for production, broadly defined, in the rural and secondary industries, for the financing of exports and, to a lesser extent, in commercial fields.

*Typical purposes—*

*Rural*—purchase of land for development, heavy equipment, buildings and fences, land clearing, pasture development and herd improvement, etc.

*Secondary*—factory extensions, plant and machinery, special reserve stocks, financing of contracts, etc.

*Export*—Capital goods and, in some cases, activities associated with the supply of capital goods, such as installation costs.

*Commerce*—not to finance consumption expenditure.

Usually, loans will be made for fixed periods and amortized by regular instalments. Some departures may be found, e.g. in case of rural loans which do not produce income in the early stages.

As a general rule, loans will be for not less than three years and the range will generally be from three to eight years or possibly a little longer.

There is no fixed ceiling to size of individual loans. Some loans for export finance may have to be substantial but, *so that the needs of small business may be given full support, it was not considered that other classes of loans will be for very large amounts.*

With regard to interest rates it was intended that the broad pattern would be consistent with overall interest rate policy as determined from time to time, and trading banks will keep Reserve Bank informed about rates being charged.

“These arrangements make very substantial resources available for this necessary class of finance, without subtracting from the capacity of the banks to carry on their other forms of lending. I am confident that they will satisfactorily meet requirements in the new context of development in Australia and of our trading relations with the world abroad.”<sup>2</sup>

By mid-1963, approved term loan commitments had almost equalled funds set aside in term loan accounts. Accordingly a further 1% of deposits was set aside (£19 million), 2/3rds from S.R.D. and 1/3rd from L.G.S., making total funds of about £76 million. Indications are that this increase is also close to being exhausted.

TABLE 1  
*Outstanding advances from term lending funds, July 1963*

<i>Business</i>	<i>£m.</i>	<i>%</i>
<i>Rural</i> —Sheep	4.8	18.0
Wheat	1.7	6.4
Dairy and Pigs	1.6	6.0
Other	2.8	10.5
	10.9	40.8
<i>Manufacturing</i>	9.6	36.0
<i>Transport, Storage and Communications</i>	0.7	
<i>Finance</i>	0.1	
<i>Commerce</i> —Retail Trade	0.8	
Wholesale Trade	1.7	
	2.5	9.4
<i>Building and Construction</i>	0.2	
<i>Mining</i>	1.6	
<i>All Other</i>	1.0	
<i>Total Business</i>	26.6	
<i>Non Profit Organizations</i>	0.1	
	26.7	100.0

<sup>2</sup> Statement by the Federal Treasurer in March 1962 when announcing the arrangements for establishing term lending facilities by the major trading banks.

*Where have Loans gone?*

We can only speak in terms of actual outstandings which, at July 1963, are shown in Table 1.

It is clear, however, that, by comparison with the Development Bank, a substantially larger proportion of term loans have gone into non-rural avenues, 40% as against 66%.

An interesting sidelight on these term loan activities of the major trading banks is that the expansion of term loan outstandings (£40 million last December) has been concurrent with some significant expansion of outstandings in respect of short term loans to woolbuyers, but little if any expansion of all other outstandings. Like the experience of the Development Bank, the demand for term loans has been strong. In this regard, the comments of the President of the Bank of New South Wales last December are relevant:—

"The trading banks' special fixed loans for medium terms, introduced in 1962, to encourage development projects in business, have met with a ready response and the original term loan fund was almost fully committed by June, 1963. *On the initiative of the banks*, it has been expanded by a further £19 million to a total of £76 million.

It should be borne in mind that the funds so set aside are provided entirely from existing trading bank assets, and the only addition to effective lending resources is the extent of releases from S.R.D., two-thirds of the total of the fund, which would not otherwise have been available for normal advances.

The use of this special revolving fund from which to make term loans implies borrowing requirements different from normal borrowing needs. The distinction, however, is by no means clear in practical application, and in effect it imposes a ceiling on, and official control over, development finance provided by banks. We claim that many of our normal advances are of a developmental character, and it is probable that more of them will be granted on a fixed loan basis within the banks' ordinary lending operations. There is greater scope for more term loans alongside the overdraft system".

The emergence of these two newcomers in the field of farm credit supply suggests the recognition of the fact that, previously, or certainly in the more recent past, rural credit facilities were inadequate, at least in terms of the type of finance available and the terms and conditions of its provisions. It might, perhaps, also be argued that their emergence, and the amount and source of the funds allocated to them would appear to discount the well-worn approach that the economic problem of resource capacity and the earmarking of additional loan funds to farming is a major obstacle.

Be that as it may, it could be said, before the recent establishment of the Commonwealth Development Bank and the trading banks' term lending arrangements, that credit facilities available to farmers in 1960 were "much the same as those at the turn of the century". When one considers the very marked changes in Australian farming, it is perhaps a cause for surprise if not concern that our rural credit facilities have not displayed that flexibility, that capacity for modification and adaptation, that increasing sophistication that has characterized other sectors of the economy and the credit markets available to them. Undoubtedly, some inherent characteristics of farming and the organization of its resources has been a factor in this situation.

In addition, to the extent that the major trading banks are the major source of rural credit supply, the operation of Reserve Bank and other related policies to limit the credit supply from the trading banks is, at times, a significant supply limiting factor.

It might be remarked that the implications of Central Bank policy as a modifying influence on the extreme effects of varying levels of liquidity in the banking system almost certainly have some significance for the banks' farm credit policies. Fluctuations in Australia's overseas reserves and the liquidity of the banking system are still quite closely associated with fluctuations in farmers' incomes and expenditure. Thus, the application of Central Bank measures to restrain bank lending and expenditure during the upswing and downswing could act to damp down the level of farm investment during those periods when farmers are most likely, on both liquidity and psychological grounds, to embark on development expenditure.

I do not propose, in the time available to embark on a lengthy discussion of rural investment and farmers' decisions. But I feel that the apparent relation between the degree of farm income fluctuation and the level of farm investment may have more than passing relevance to the implications of Central Bank stabilizing policies for bank farm credit policy and the level of farmers' expenditure on development work. In any case, our current knowledge of the farm investment process is by no means as satisfactory as might be wished.

Whether, in fact, the introduction of the term lending arrangements has resulted in a net increase in the supply of farm credit, or an adaptation of the pattern of its use, is a question which it does not seem possible to answer at this juncture. On the other hand, it seems reasonable to assume that a major part of Development Bank lending (by virtue of the source from which its funds are derived and the terms on which it is undertaken) is supplementary to commercial supplies. It would appear, however, to be (in the rural field, at least) a substitute for special purpose loans from public funds that might otherwise come from Government sources.

Both the Development Bank and the major trading banks' term lending arrangements represent significant adaptations of previously existing farm credit supply. Both represent an endeavour to introduce modifications that will cater more effectively for development needs in farming and industry. It is perhaps too early to reach firm conclusions about their effects on, or adequacy for, the purposes they are designed to serve. All that can be said is that they are contributing to a need and that they will need to be capable of expansion.

The whole background to our farming industries is subject to rapid change in the present circumstances of Australia's economic growth. In this connection we have, perhaps, been experiencing for the first time positive steps to adapt farm credit services to the needs of growth and development, rather than to ameliorate the effects of general economic recession or dislocation.

My final comment is to suggest that we know much less than we would like about the factors affecting the supply of (and demand for) farm credit. Relatively little work of a detailed character has been done (here or overseas) on the elasticities of supply (and demand) for farm credit. Yet the subject is sufficiently important to warrant some resources being allotted to this specific field of study.