THE ROLE OF THE DEVELOPMENT BANK IN RURAL CREDIT*

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Before talking about the role of the Development Bank in Rural Credit I will spend a few minutes in a brief description of the Commonwealth Development Bank.

It is one of three banks which form the Commonwealth Banking Corporation, the other two banks being the Commonwealth Trading Bank and the Commonwealth Savings Bank, and you will know that the Corporation and its constituent banks are now quite separate from the Reserve Bank.

The Commonwealth Banking Corporation has a Board of eleven members including a full-time Managing Director and Deputy Managing Director.

The Board of the Corporation is responsible for determining the policy and controlling the affairs of the three banks.

Each of the three banks has an Executive Committee consisting of the Managing Director and four of the other members of the Board and I, as Chairman of the Board, may, and do, attend the meetings of each Executive Committee.

An Executive Committee's function is to ensure that effect is given by the particular Bank to the policy as determined by the Board and to any directions given by the Board in relation to the affairs of the particular Bank.

The members of the Executive Committee of the Commonwealth Development Bank are :—

Mr. H. N. Giles (Chairman) of Adelaide, who is Managing Director of Elder Smith and Co. Ltd.,

Mr. E. B. Richardson, Managing Director of the Commonwealth Banking Corporation,

Sir Albert Axon, a consulting engineer and Chancellor of the Queensland University,

Mr. R. G. Baxter of Melbourne, an industrial consultant and war-time Director of Industrial Welfare in the Department of Labour, and

Mr. E. T. Loton of Western Australia, Chairman of Westralian Farmers Co-operative Ltd. and director of a number of rural companies.

With your special interest in primary industry, you will have noted that two members of the Executive Committee of the Development Bank are actively associated with pastoral houses. I can assure you that these

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two colleagues of mine have an intimate knowledge of the problems of the rural community as a result of their lifetime association with the problems of the man on the land.

Each Bank has a General Manager, appointed by the Governor-General upon the recommendation of the Board.

The General Manager of the Development Bank is Mr. B. B. Callaghan who was formerly a director of the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation.

The staff for the three banks is supplied from what is termed the Commonwealth Banking Corporation Service. Employees are, therefore, inter-changeable between the three Banks.

Each Bank is a separate entity but whereas the Commonwealth Trading Bank and the Commonwealth Savings Bank have been constituted to operate on bases similar to those applicable to other Australian trading and savings banks, the Commonwealth Development Bank has been constituted differently.

Trading banks and—for that matter—savings banks, conduct their business from funds provided in the main by deposits, either withdrawable on demand or at very short notice but the financing of the Development Bank is on a different basis. It is true that it has power to receive money on deposit but it is most unlikely that it will receive deposits on any scale and, in fact, it will have to rely upon capital and borrowings. Its capital and reserves at present total about £20 million being £15 million taken over from the Mortgage Bank and Industrial Finance Departments of the Commonwealth Bank, and the sum of £5 million obtained, in terms of the relevant Act, from the Reserve Bank at the commencement of the Development Bank on the 14th January this year.

The Development Bank has power to borrow money and borrowings taken over at its commencement in January totalled approximately £16 million.

The net profits of the Bank in each year will be placed to the credit of the Development Bank Reserve Fund and there is provision for amounts to be transferred from the Reserve Fund to capital.

The Development Bank is designed to be supplemental to the existing banking system and not competitive with it. In fact the private trading banks are entitled to be appointed as agents of the Development Bank for the receipt and transmission of loan applications and the major trading banks have availed themselves of this right.

Development Bank offices have been set up in the capital city of each State. Applications are received direct at each such branch which also deals with applications received through the Commonwealth Trading Bank and other banks in the State concerned.

I mentioned earlier that the capital and reserves of the Development Bank at its commencement totalled approximately £20 million and that its borrowings were approximately £16 million. These are large sums of money but, of course, with the exception of the £5 million from the Reserve Bank, a great proportion of the funds was already invested in the loans and other accommodation granted by the Mortage Bank and Industrial Finance Departments of the Commonwealth Bank. As we are interested in rural credit, I mention only the figures of approximately £6 million in loans taken over from the Mortgage Bank Department, and hire purchase business in agricultural tractors and machinery running at the rate of about £3 million per annum which was financed by the Industrial Finance Department.

However, with the £5 million new capital, liquid assets taken over and funds from repayment of existing loans, the Development Bank has a relatively sizable capacity to lend for developmental purposes.

I have tried to give you a quick description of the Development Bank —what it is—how it is controlled—and what money it has.

I think, however, that, before discussing the role of the Development Bank in Rural Credit, I should tell you more about its objectives, for it is in giving effect to these objectives that the role of the Development Bank is made effective.

Where do we find these objectives ? In the case of companies the objectives are set out in the Memorandum of Association. For the Development Bank we find the objectives in sections of the Commonwealth Banks Act 1959.

Section 9 (2) of that Act sets out—in relation to the Commonwealth Banking Corporation Board—that " It is the duty of the Board within the limits of its powers, to ensure that the policy of the Corporation, and the banking policy of the Trading Bank, of the Savings Bank *and of the Development Bank*, are directed to the greatest advantage of the people of Australia and have due regard to the stability and balanced development of the Australian economy."

Then there is section 72. Quoting only what is appropriate to a talk about rural credit, this reads—" The functions of the Development Bank are—(a) to provide finance for persons for the purposes of primary production in cases where, in the opinion of the Development Bank, the provision of the finance is desirable and the finance would not otherwise be available on reasonable and suitable terms and conditions ; and (b) to provide advice and assistance with a view to promoting the efficient organisation and conduct of primary production."

Section 73 adds further relevant considerations. This section reads—

> " (1) In determining whether or not finance shall be provided for a person, the Development Bank shall have regard primarily to the prospects of the operations of that person becoming, or continuing to be, successful and shall not necessarily have regard to the value of the security available in respect of that finance.
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> (2) The Development Bank shall not provide finance for a person to enable that person to acquire goods for use otherwise than in the course of his business."

The objectives and functions quoted indicate that they are subject to very wide interpretation and therefore allow a flexible operating policy which can be varied to suit changing conditions or needs.

The broad principles of the present policy of the Development Bank were made public some time ago. However, I will mention to you now those points which relate to rural lending for, although later I will make some general comments on rural credit, there is no doubt that an assessment of the Development Bank's role in rural credit must spring from an understanding and interpretation of its policy in rural lending.

(Perhaps I should make it clear here that the Development Bank does not regard itself predominantly as a rural bank nor as an industrial bank. It will endeavour to do justice to both facets of its charter.)

The main policy points applying to rural finance are :—

1. Loans over all fields of primary production are considered. The Bank normally expects that the finance provided will result in an increase in primary production or improvement in productivity,

and that the borrower is directly engaged in primary production as a principal activity or intends to be so engaged.

2. The Development Bank must consider that the finance sought is not otherwise available on reasonable and suitable terms and conditions.
3. No maximum amount has been set for loans that will be made available but for rural purposes loans below £25,000 are preferred. In the absence of exceptional circumstances, applicants are expected to have a reasonable equity in their undertakings.
4. The efficiency, managerial capacity and integrity of the applicant as well as the prospects of the industry in which the applicant is engaged or intends to become engaged, are important considerations in the assessment of proposals.
5. Within the above broad outlines, an over-riding consideration in determining the administrative policy of the Development Bank from time to time will be the need to ensure that its funds available for lending are directed towards the best interests of Australia through the approval of those proposals which have the more important developmental features.
6. The need to ensure that the Bank's funds are available for developmental purposes means that, except in special circumstances, the Bank cannot approve applications which do not have any developmental features and which merely involve a change of ownership of land or other assets, or the taking over of debt from another lender.
7. Finance is usually made available by way of term loan repayable over periods suited to each individual case.
8. Repayment is expected by instalments of principal generally half-yearly with separate provision for interest, or in suitable cases, equal periodical payments covering principal and interest are arranged. Where a new enterprise is involved, the first repayment instalment date is a matter for special consideration—a repayment holiday is permitted if appropriate.
9. Progressive loans which may be drawn over a reasonable period are provided.
10. Borrowers are expected to provide the maximum security available, but no specific lending margins against particular types of security have been set and each case is considered on its merits.
11. At present the interest rate is 6% p.a.
12. The Development Bank provides hire purchase facilities for the acquisition of producer goods such as farm tractors and agricultural implements. The term of hirings depends on the type of goods financed.
13. At present the basic hiring charge for new goods is at the rate of $4\frac{3}{4}\%$ p.a. flat with a reduction of $\frac{1}{4}\%$ p.a. for agricultural tractors and implements. The minimum deposit sought varies according to the type of goods being financed, but normally is between 25% and $33\frac{1}{3}\%$ of the net cash price.
14. The Development Bank accepts applications for hire purchase finance at its own branches and at branches of the Commonwealth Trading Bank and Commonwealth Savings Bank.

At this point I will make a few comments on rural finance generally and endeavour to link the Development Bank policy with these comments to show how the Development Bank fits into this field of credit.

Perhaps from one viewpoint, rural credit could be said to include the loans provided by the Reserve Bank to finance various commodity boards and the advances provided by banks to pastoral companies who in turn provide finance to primary producers. But, for the purposes of this paper, the term " rural credit " is confined to finance, in any of its forms, made directly available to a primary producer.

In this concept there are three main purposes for which rural credit may be used.

Firstly—to improve a primary producer's standard of living,

Secondly—to re-distribute income within the primary producing community,

Thirdly—to increase a primary producer's income ; this includes the important field of expenditure on items which will improve farm productivity.

Another purpose would be the use of rural credit from one source to repay rural credit from another source.

What I mean in my reference to the use of credit for improvement of the standard of living is the direct expenditure of the finance on such things as furniture, education of children and other expenditure which does not increase production or reduce costs. These may be highly desirable purposes but at least in general they can be regarded as outside the scope of Development Bank finance if only because of the statutory requirement that the Development Bank shall not provide finance for a person to enable him to acquire goods for use otherwise than in the course of his business. I add, however, that we do not include normal housing requirements in this category. The house is an essential part of the farm and as such is within the scope of Development Bank finance.

The use of rural credit to redistribute income is often interpreted along the lines of a defined policy of providing credit for those who are most lacking in capital and restraining expansion of those who are well established. This would have the tendency to increase the incomes of those on low incomes and reduce or at least restrain the increase of those on high incomes. I do not propose to offer any comment on the pros and cons of such a policy other than to say it is certainly no part of the Development Bank's policy to attempt actively, or by design, to influence a redistribution of primary producers' income.

The Development Bank is concerned with the assessment of individual proposals to it and whether or not a " re-distribution of income " effect would follow would be of little interest.

Assistance to primary producers who are taking up blocks as a result of closer settlement of larger holdings, would of course have an element of this " re-distribution of income " effect but there is a distinct overlapping into what I consider to be the most important field for the use of rural credit, i.e., the use of credit to increase a primary producer's income with a concomitant increase in national output.

The income of a primary producing enterprise is of course derived from the application of labour and capital to land. The use of credit to acquire additional land would provide the means to increase an individual primary producer's income but, unless there follows a greater or more efficient application of capital and labour to that land, there is likely to be little gain in national output. However, there is no doubt that there are many cases where acquisition of more land will enable a primary producer's capital in the form of plant, etc., to be put to better use and enable him more effectively to use his labour and management capacities. There are other cases—especially with dairy farms—where holdings are too small to give a reasonable living standard and additional land is almost an essential to allow the farmer to apply his labour and capital to earn a satisfactory income.

Apart from the acquisition of *additional* land, the application of additional capital and labour to *existing* land can provide the means of increasing a primary producer's income. This will also result in an increase in national output which in most instances would be of national benefit as well as being of benefit to the individual primary producer. The provision of rural credit for these purposes is therefore desirable and important.

In most cases, the expenditure will result in a reduction in cost per unit of output, that is, an increase in productivity but, even where the law of diminishing returns applies, it may still be desirable individually and socially to obtain a greater output from the land.

In theory it could be argued that the best use of rural credit would be to provide finance to those primary producers who are likely to obtain the highest rate of return on additional capital and labour employed.

But who is going to collate the information on the primary producers ready and willing to use additional capital and labour, the extent to which they wish to borrow for these purposes, and the expected rate of return on the additional funds employed ? In any case, this could raise a political problem of the first magnitude. In the ordinary course, a lending body should not arrogate to itself the right to make this type of determination on a national scale even if some such judgment would have to be made if, in a given period and subject to Government policy, a lending body wished to ration funds available for lending to those who could make " best " use of the credit.

So far as the Development Bank is concerned, the approach adopted is that it will examine the proposals put to it to judge whether good developmental use is likely to be made of the credit sought. It is implicit in this approach that the funds should return in income something more than the cost of the additional funds. To the extent of this surplus the loans can become self-liquidating and without this factor there would be little or no real gain to the individual primary producer.

In the rural sector, development includes such things as clearing, fencing, water supply, irrigation works, pasture improvement, erection of farm buildings and provision of plant and machinery where its acquisition is associated with a developmental project or will add significantly to efficiency. Very often, credit is sought where the total expenditure includes non-developmental as well as developmental expenditure and it is obvious that one will not proceed without the other. The Development Bank will consider providing the whole finance sought in such cases but as a general rule looks for a fairly high developmental proportion. The " development use " principle is also interpreted, where appropriate, to enable the giving of assistance for the purchase of livestock to provide suitable quantity or quality, or to provide working funds where the need for these has arisen from outlay on developmental work currently being undertaken or even where such work has been undertaken in the immediate past ; also in cases where efficiency is being impeded by a shortage of working funds.

Since the Development Bank will only provide finance where it is not otherwise available on suitable terms and conditions, it is sometimes referred to as a " lender of last resort ". This description is to some extent correct but not in the sense that it could be applied to some State rehabilitation authorities whose function is to provide finance where it is not available because of the *doubtful prospects* of the applicant. Development Bank finance is designed to assist those whose needs are not met by other lenders *despite the fact that they have reasonable prospects of success.*

Perhaps this duty of the Development Bank to pay regard *primarily* to the prospects of the applicant being successful and not necessarily to the value of the security, is its greatest distinguishing feature from other Australian lending institutions but it means there is a higher overall risk factor in Development Bank lending. However, this higher risk factor is not covered by a high rate of interest nor is any advantage or " subsidy " given to the borrower by a low rate of interest.

Here I think I should interpolate a comment with which you, as agricultural economists, will be concerned—it relates to the difficulties facing the new settler of today and, in particular, it relates to the limited repayment-power of the new settler and, because his repayment-power is limited, his borrowing potential is correspondingly low.

The Development Bank has had this problem prominently before it in relation to the opening-up in various parts of Australia of new areas of leasehold land and it has found, as others have no doubt found before it, that the new settler in such areas must have a greater equity than his counterpart of a few years ago because the costs facing the settler today are greater and yet his returns have not correspondingly increased. This, I believe, is a problem to which governments must give consideration.

I feel confident that the Development Bank, by filling the gap in the sources of finance available, will help to encourage a resurgence of this pioneering spirit and inspire men to undertake bold new schemes which will not only benefit them personally but the nation as a whole.

I do not mean by this statement that the Bank will be prepared to put up money to finance wild-cat schemes.

But before the creation of this new source of finance, there was no provision for the primary producer who had conceived a sound new development scheme with every prospect of success, but lacked the capital security to obtain the finance he needed.

Because, as I have said, the duty of the Commonwealth Development Bank is to be concerned primarily with a man's prospects of success rather than with the value of his security, this obstacle need no longer exist.

The debt the new settler can service is, of course, determined by the costs he incurs and the returns he receives and also by the period within which he must repay his borrowing. It scarcely needs to be said that one important cost is the interest on his borrowing but this is only one of the costs. Again, the period of repayment is important but in the Development Bank a few years of repayment holiday is no novelty and loans to new settlers are generally long-term.

It is true that if the new settler could get interest-free or low cost money, he would be that much better off but I do not believe it is appropriate for a bank to lend money to one group within the community at a rate below the cost of the loan to that bank. To put it another way, it is the fact that among the charges a new settler has to meet is interest at the rate of the day. But, if a subsidy is to be granted to any particular group, the subsidy should be paid as such and not disguised as a reduction in the rate of interest or other cost.

The Development Bank has borrowed substantial sums of money from the Savings Bank and it pays 5% p.a. on those borrowings. In calculating its own costs, therefore, the Development Bank must take into account this charge which corresponds to the rate of interest on Government long-term Bonds. And yet, although it is lending in a field where there is a very high overall risk factor, the Development Bank does not charge a specially high rate of interest.

However, it follows that both in the interests of the borrower and the Development Bank the prospects of success of a borrower must be established to the best degree practicable. This, of course, makes the consideration of Development Bank applications in many cases somewhat difficult. Especially is this so because many developmental projects need to be spread over a considerable period of time and even require a continued application of moneys for some years before the ultimate benefit in increased income is realised.

You may remember that there is a provision in the Commonwealth Banks Act for the Development Bank to " prove advice and assistance with a view to promoting the efficient organisation and conduct of primary production " The Bank has on its staff a number of qualified rural specialists and valuers and these staff are of great value in helping the Bank in the difficult problem of assessing the degree of prospects for success in the projects put to it for financing. It could also be said that these officers are available for general advice but, in providing these services, it is certainly not the intention of the Bank, when talking to farmer customers, to cut across the field of outside specialists, consultants, State advisory services and others.

Some primary producers, of course, do not use finance in the best way to increase their income—some tie up money in machinery of bigger capacity than they need or which is used very infrequently. Others spend money on pasture improvement but do not get the full benefit from it because they do not—or are unable to—increase their stock numbers sufficiently. Therefore, before spending money on development—primary producers should ask themselves how the proposed outlay will fit in with their whole farm programme and by how much it is likely to increase their income.

A farm programme—at least from the developmental aspect—should be a long range plan with a division into periods of the programme and associated expenditure. More detail would go into the plan for the earlier periods but the longer range objectives and their likely finance requirements need to be kept in view.

There should be an integration of the various development outlays planned. There would be little value in planning a pasture improvement programme without consideration being given also to the financing of allied expenditure on machinery, fencing, additional water supply, buildings and livestock. I have mentioned pasture improvement particularly as in many parts of Australia this is essentially a long term development and it is not uncommon for net farm income to fall in the initial years of development.

The kind of planning I have been talking about implies a careful assessment of physical factors, a conversion of these into estimated capital outlay, expected incomes, allowance by discounting procedures where income from current expenditure will not be received for some years, preparation of cash budgets and so on. It would be rare to find a primary producer who examines his business or attempts calculations to the extent

I have just mentioned. The weather factors which affect output and the variation in prices for his output from year to year are formidable discouragements to detailed financial planning of this sort. In addition, the skills, training and inclinations of primary producers are not generally directed closely to these ends. However, at least from the physical planning side there is a growing interest in Australia in the formation of Farm Improvement Clubs which can be of considerable benefit, and the dissemination of knowledge by your Society and agricultural economists generally is a pleasing modern trend.

There will have been nothing new to you in what I have been saying about farm development programmes. In fact, you, as members of an Agricultural Economics Society, will be far more familiar than I with the detailed and technical considerations needed in this type of planning.

Why I have said it, is because it is so closely allied to Development Bank finance. It is not unreasonable for other lenders to be hesitant in providing finance for development projects where security aspects are doubtful or repayment is not reasonably assured from present income. It is also hardly reasonable for them to be expected to undertake the investigation and close analysis needed to assess the prospects for success of such projects.

The Development Bank has been established to fill this gap in the lending field but it has responsibilities for the prudent handling of its funds as well as in providing finance for developmental purposes. Therefore, questions of extent of security, managerial capacity, borrower's equity, degree of probability of success of the project are interdependent and have varying degrees of importance in individual applications.

Establishing prospects of success can be difficult, particularly where additional income may not be generated quickly and finance is needed on a basis where no principal repayment will be practicable for some years. It is in this field that programming and budgeting is of most importance. Apart from the personal capacities of the applicant, the fulfilment of a plan will depend largely on the accuracy of the facts incorporated in it and the wisdom of the various opinions or judgments applied in making the forecasts which are part of every plan. Many primary producers are able to make well informed guesses but plans based on proper techniques and detailed orderly thinking are more likely to be successful. Such organisations as this Society are, through the efforts and positions of their members, playing an important part in the spreading of the knowledge and techniques which should bring about a gradual extension in budgeting and planning techniques in primary production enterprises. And the extension of such techniques fits in eminently with the types of rural developmental purposes for which Development Bank finance is appropriate.

In relation to the large sums involved in many financial transactions which occur in the business world today, the funds of the Development Bank are not large, especially when its function of providing finance applies to industrial as well as rural purposes. However, its function is to fill a gap and it is usually the smaller enterprise which qualifies for its assistance. So far as rural finance is concerned, the provision of finance only for applications which have developmental features and good prospects of success, means the spreading of assistance over a large number of borrowers and is in direct keeping with its duty of conducting its activities to the greatest advantage of the people of Australia and in furtherance of the stability and balanced development of the Australian economy.