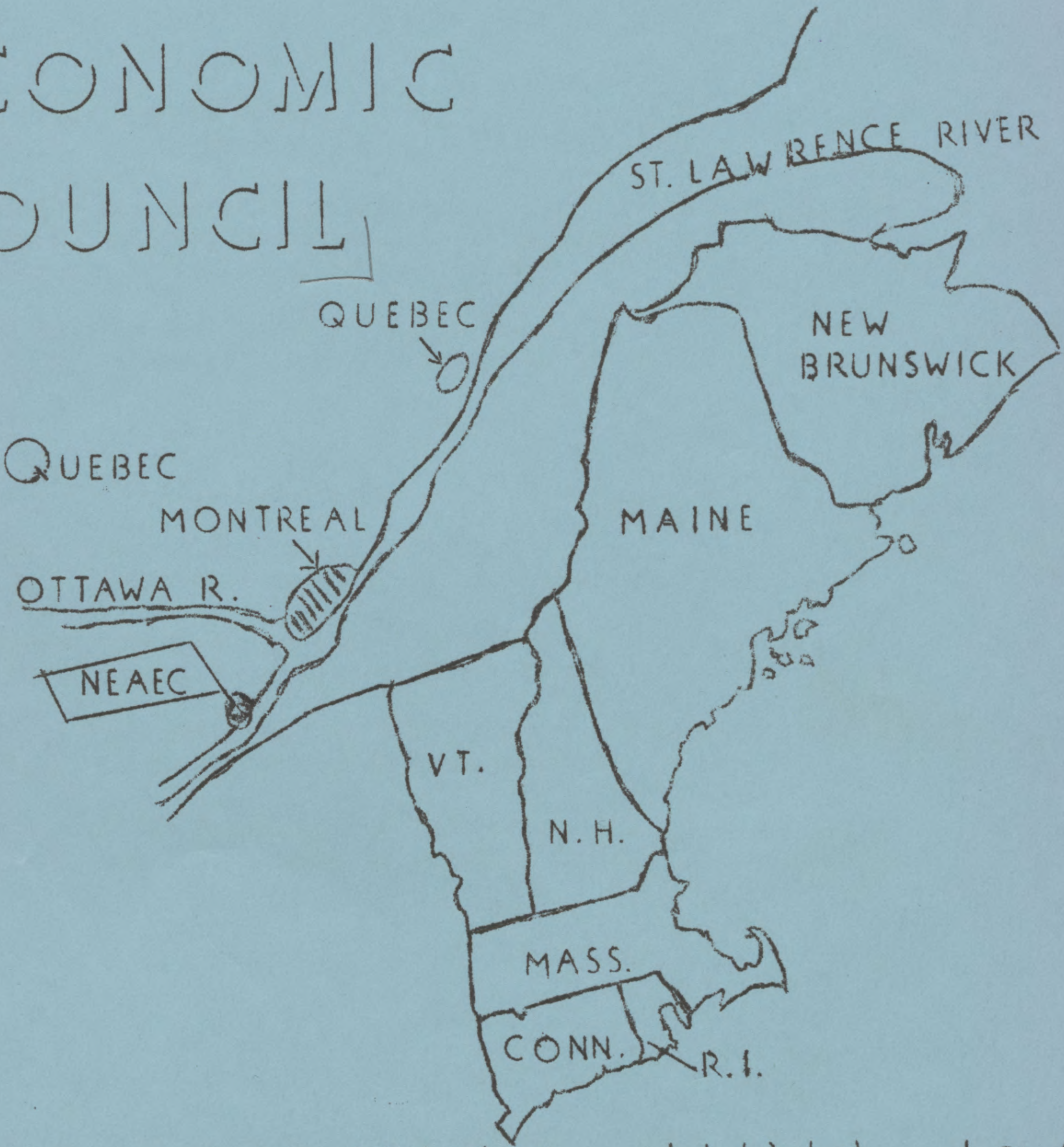
a E a (pd)

NEW ENGLAND AGRICULTURAL ECONOMIC COUNCIL



PROCEEDINGS, JUNE 1960

AT

MACDONALD COLLEGE - McGILL UNIVERSITY

STE. ANNE DE BELLEVUE, MONTREAL, QUEBEC, CANADA

FARM CREDIT PROBLEMS

R. B. Tootell
Governor of Farm Credit Administration

A selfish motive prompted me to accept your invitation to appear here on your program this year. Ten years ago this spring, I met with your group at Durham, New Hampshire, and remember it as a stimulating experience. I welcome this opportunity to talk with you some about farm credit problems, but more particularly hope to get your views about the credit problems of New England farmers.

It is my belief that your group is somewhat better informed about agricultural credit matters than many of the agricultural economists in the country. It is my understanding that for each of the last 8 years some of you, or your associates, have been meeting with the officers of the Farm Credit banks at Springfield to discuss credit matters. In spite of your general knowledge of the subject, I should like to take just a few minutes to review some of the highlights pertaining to agricultural credit and related matters.

It seems to me that the substitution of capital for labor has been the most important aspect of the agricultural revolution of the past two decades. Capital per farm and per worker both have increased approximately five times since 1940, measured in terms of 1958 dollars. Credit has played a rather important role.

No doubt most of you are familiar with the study made by the National Bureau of Economic Research dealing with capital formation in agriculture. This study shows that from 1900 to 1950, 78 percent of the farmers' increment of capital was from earnings, while 22 percent was from credit. It is estimated that from 1941 to 1945, more than 90 percent was from earnings, while in the post war period since 1946 approximately one third has come from credit. Credit has been the farmers cheapest "production" tool with the possible exception of fertilizer.

Farm debt reached a low of approximately $7 billion in 1945. It has gone up rather steadily until now it stands at $22 billion. The Balance Sheet of Agriculture shows that farmers have at least an 88 percent equity in their holdings. Unfortunately, this is not evenly distributed and there are some farmers with what I would consider really burdensome indebtedness. Another important point is that the land market has risen almost continuously since 1940.

Now from this brief review of the agricultural credit situation I will proceed to discuss the topic "Farm Credit Problems", but will do so from the standpoint of agricultural lenders. I hope the discussion period will permit time for you Council members to say some things about the credit problems from the farmers' standpoint.

Actually there have been relatively few lender problems during the last 15 or 20 years. Agricultural income probably never has been relatively as good over as long a period of time. Delinquencies and foreclosures almost disappeared during this period. Rising land prices erased errors of judgment in both real estate and short term lending. Active demand for farms made it easy to transfer them to "stronger hands" as credit weaknesses developed. During this period our Federal land bank people have been genuinely concerned with the problem of how to loan enough to really be of service to farmers without adding unduly to the forces of land price inflation.

Today's biggest problem for agricultural lenders (I state only partially facetiously) is the inability to see clearly what lies ahead for agriculture. You see, vision -- the ability to anticipate -- is very important for agricultural lenders and especially for those making long term loans. Closely related to this problem is that of how to keep abreast of a very dynamic agriculture.

We are past the end of the era in which most anyone could make money farming. Present land prices in most areas cannot be justified except for farm enlargement or for nonfarm uses. The United States Department of Agriculture shows earnings on farm land for 1959 were only 3 percent. This is less than the average return on common stock for 1959. Land sales have slowed down, and some areas have for the first time in years registered a decrease in sales prices from a year earlier.

What would be the consequences of a 15 to 20 percent drop in farm land prices from this, the highest level in history? Would this not represent only a "technical" adjustment which the stock market presumably has experienced in recent months? I would expect such a drop to change some attitudes about agricultural credit.

It is our view that lenders may look forward to more collection problems than they have experienced in a long time. There are a few straws in the wind. Tax delinquency is showing some increase, as is also loan delinquency. Foreclosure rates, although very low, seem to be starting up slightly. We are seriously pondering the question as to what extent mortgage lenders have been a party to enabling farmers to bury operating deficiencies by successive increases in real estate loans.

Another problem that bothers lenders is the fact that many people seem to believe that credit can be substituted for income more or less indefinitely.

Another serious problem we might term "obsolescence" of mediocre farms and mediocre farm managers. Poor or even fair farms cannot compete and repay debt as many of them did in the past. Business management is an increasingly important ingredient for success of commercial farms. All farmers who have been successful with typical size operations in the past are not capable of successfully managing the larger farm business required today. As one of my midwest friends said recently, "We have too many quarter section farmers on half section farms." How can we as lenders recognize potential managerial ability?

Another problem related to this is how to drop managerial borrowers. The type I am thinking of often have been successful association members for years, but with the price-cost squeeze they cannot make it.

Split financing is another of the problems. Often times when a loan starts developing trouble, the lender finds that the borrower owes a variety of dealers on both sides of Main Street. The evils of split financing is a very fertile area for borrower education.

Widely fluctuating rates of interest have been a special problem during much of the past 6 years. It is a particularly serious problem for the Cooperative Farm Credit System which hires its loan funds. Banks and insurance companies have considerably more flexibility in their use of loan funds. Let me illustrate this problem. Each month the Federal intermediate credit banks sell 9-month debentures in the market. In July, 1958, their debentures sold for 1.48 percent, including commission. However, in January this year, just 18 months later, the market required 5.49 percent on these 9-month debentures. The banks for cooperatives and Federal land banks have experienced comparable problems.

A legal interest rate limit of 6 percent, especially in most of the New England States, is another real problem. It is not politically popular for State legislatures to change these rates. If money costs remain relatively high over a period of time, these ceilings may limit the credit available to farmers.

Finally, I would say the biggest single problem of agricultural lenders is that of obtaining and keeping employees who have the aptitude and the training to constructively finance farmers and not just lend them some money. We have a good many such men in our associations but we do not have enough. We hope your colleges of agriculture will make a real effort to train men. We particularly need young men who have training in farm business and farm management. We want men who are observant, analytical, and who are well balanced. I am not unconscious of the fact other employers also look for such men.

So much for specific problems of agricultural lenders. I shall now comment briefly on the demand and supply situation as it pertains to credit. We believe the demand for agricultural credit will continue to increase although perhaps not at quite as rapid a pace as in the last few years. Credit will be needed to finance farm enlargement generally and the adjustments and innovations that are sure to come in the decade of the 60's. A considerable amount of the credit used in agriculture is to finance transfers of farms and farm property, including the equity interests of young people who leave the farms. As additional farm families leave agriculture, the amount of credit involved in financing transfers will increase still more.

As we see it, there will in the aggregate be adequate credit to finance the needs of agriculture. The combination of private individuals, commercial banks, the Cooperative Farm Credit System, and the Farmers Home Administration constitute a "complex" which we believe will meet the legitimate credit demands of farmers.

We believe that the Cooperative Farm Credit System has undergone rather rigorous testing in recent years involving tight money periods. It has served as a mechanism through which farmers have pooled their credit and have been able to compete successfully for loan funds with commerce and industry. The System increased its loan volume 105 percent in the last 6 years. In 1959, it loaned farmers and their cooperatives $4 billion. It order to get the loan funds to do this, the banks of the System sold $3.6 billion of bonds and debentures on the open market in 1959. Since the beginning of the tight money period, the banks and associations have increased fairly significantly the porportion of agricultural credit business which they extend. Total for the System is approximately 17 percent. Federal land banks now have 19 percent of the farm mortgage business; production credit associations 13 percent of the non real estate business. The banks for cooperatives are estimated to be doing approximately 55 percent of the lending to farmer cooperative associations.

I look forward now to questions which you people may care to ask during the discussion period, and to your views with respect to credit problems with which your New England farmers are confronted.