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SOURCES AND USES OF FUNDS IN AGRICULTURE

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SOURCES AND USES OF FUNDS IN AGRICULTURE

WHEN ONE CONSIDERS THE SOURCES OF FUNDS IN AGRICULTURE, THOSE OF US IN THE BUSINESS OF PROVIDING THE FUNDS THROUGH CREDIT INSTITUTIONS IMMEDIATELY REMEMBER THE CREDIT CRUNCH OF 1966-67 -- WHEN THERE WAS GENUINE CONCERN AS TO WHETHER FUNDS WOULD BE AVAILABLE, AT ANY PRICE. AS IT TURNED OUT, CREDIT DEMANDS WERE MET BUT UNDER RESTRICTIVE TERMS FOR AWHILE. A GOOD EXAMPLE OF RESTRICTION WAS THE TIME LIMITATION PLACED ON LOAN COMMITMENTS -- THE BORROWER COULD HAVE THE FUNDS TODAY BUT NOT NECESSARILY NEXT WEEK.

TODAY WE HAVE A DIFFERENT SITUATION. THE PRICE HAS BECOME THE DOMINANT FACTOR BUT THERE SEEMS TO BE LITTLE QUESTION THAT FUNDS WILL BE AVAILABLE FOR AGRICULTURE. PERHAPS, THE EMPHASIS ON FOOD, AND THE COST OF FOOD, HAS MADE AMERICA REALIZE THAT FINANCING THE FARMER IS A SOUND INVESTMENT. SPEAKING TO THE SOUTHERN FARM FORUM IN MEMPHIS EARLIER THIS YEAR, GLENN G. BROWNE, GENERAL PARTNER, QUINCEY AND CO., NEW YORK CITY (AND FORMER FISCAL AGENT FOR THE FARM CREDIT BANKS) SAID: "THE INVESTORS AND SAVERS OF THIS COUNTRY -- ALTHOUGH PRESENTLY COMPLAINING ABOUT

HIGH FOOD PRICES -- NEVERTHELESS, HISTORICALLY HAVE LOOKED UPON AGRICULTURE AS A PRIME PLACE TO PUT THEIR MONEY. AT A PRICE, TO BE SURE -- BUT THIS IS ALWAYS THE CASE IN A FREE ENTERPRISE SYSTEM WHERE COMPETITION IS THE NAME OF THE GAME." THUS, IF HISTORICALLY THERE HAS BEEN FAITH IN AGRICULTURE AS A Viable INDUSTRY THEN PERHAPS 1966-67 WAS AN EXCEPTIONAL SITUATION THAT OUGHT NOT TO TROUBLE OUR FORWARD THINKING.

MR. BROWNE ALSO STATED: "IT IS MY OWN PERSONAL VIEW, BASED ON EXPERIENCE WITH THE RESOURCEFULNESS AND INGENUITY OF THE AMERICAN FARMER THAT FUTURE PROBLEMS WILL LIE NOT IN THE OUTPUT SIDE OF AGRICULTURE BUT WITH INPUTS SUCH AS MACHINERY, FERTILIZER, STORAGE AND TRANSPORTATION FACILITIES, AND WITH VARIOUS KINDS OF ENERGY. I DISTINCTLY DO NOT PLACE FINANCIAL OR FARM CREDIT RESOURCES, IF YOU WILL, IN THE CATEGORY OF POTENTIAL SHORTAGE."

ON WHAT BASIS ARE AMERICA'S INVESTORS WILLING TO PLEDGE THEIR SAVINGS TO AGRICULTURE? IN ADDITION TO THEIR CONCERN FOR ADEQUATE SUPPLIES OF FOOD AND FIBER, AT REASONABLE PRICES, THE INVESTORS HAVE ONLY TO LOOK AT THE FINANCIAL STRUCTURE OF AGRICULTURE

TO RECOGNIZE THE SOUNDNESS OF THE INDUSTRY.

ACCORDING TO FIGURES PUBLISHED BY THE UNITED STATES DEPARTMENT OF AGRICULTURE, ON JANUARY 1, 1974, THE BALANCE SHEET OF U. S. AGRICULTURE SHOWED:

ASSETS	\$454 BILLION
DEBTS	<u>80 BILLION</u>
EQUITY	\$374 BILLION

HOW MANY BUSINESS FIRMS CAN PRODUCE A COMPARABLE STATEMENT?

OF COURSE, AS WE EXAMINE DOLLAR AMOUNTS THESE DAYS WE MUST BE EVER CONSCIOUS OF THE EFFECTS OF INFLATION; BUT EVEN WITH A SHRINKING DOLLAR THE AMOUNT OF FUNDS USED IN AGRICULTURE, AS NEW FUNDS AND TO REFINANCE EXISTING DEBT, IS TREMENDOUS. AS AN ILLUSTRATION OF THE AMOUNT OF FUNDS USED, AT THE BEGINNING OF 1974, INSTITUTIONS OF THE FARM CREDIT SYSTEM HELD APPROXIMATELY 22 PERCENT OF THE NONREAL ESTATE AND REAL ESTATE DEBT OF AGRICULTURE -- SLIGHTLY MORE THAN ONE-FIFTH OF THE TOTAL -- WHILE IN THE PRIOR 12 MONTHS THESE INSTITUTIONS ISSUED \$11.7 BILLION IN BONDS TO FINANCE THIS DEBT.

SOURCES OF FUNDS IN AGRICULTURE ARE (1) RETAINED EARNINGS OR SAVINGS FROM THE INDUSTRY ITSELF,

(2) BORROWED FUNDS; AND (3) TO A LESSER EXTENT, GIFTS OR OTHER FREE CAPITAL. CREDIT HAS BEEN, AND WILL BECOME, AN INCREASINGLY IMPORTANT SOURCE.

LET'S TAKE A MINUTE TO IDENTIFY THE TYPES OF INSTITUTIONS PROVIDING CREDIT. FIRST, WE SHOULD DISTINGUISH BETWEEN INDIVIDUAL LENDERS AND INSTITUTIONAL LENDERS; AND THEN PERHAPS IN THE INSTITUTIONAL GROUP, SEPARATE PRIVATE SOURCES OF FUNDS FROM PUBLIC SOURCES. IN BOTH NONREAL ESTATE AND REAL ESTATE LENDING, INDIVIDUALS CONTINUE TO BE IMPORTANT SOURCES OF FUNDS -- HOLDING IN EXCESS OF 40 PERCENT OF THE DEBT OVER THE PAST 20 YEARS.

INSTITUTIONAL LENDERS VARY BY THE TYPE OF DEBT. IN NONREAL ESTATE DEBT, PRIVATE LENDERS INCLUDE, IN ORDER OF RANK: (1) INDIVIDUALS (INCLUDING MERCHANTS, DEALERS, ETC.), (2) COMMERCIAL BANKS, AND (3) PRODUCTION CREDIT ASSOCIATIONS. REAL ESTATE DEBT IS HELD BY: (1) INDIVIDUALS, (2) FEDERAL LAND BANKS, (3) LIFE INSURANCE COMPANIES, (4) COMMERCIAL BANKS. THE FARMERS HOME ADMINISTRATION IS THE PRINCIPAL LENDER OF PUBLIC FUNDS FOR BOTH NONREAL ESTATE AND REAL ESTATE PURPOSES IN AGRICULTURE.

THE TERM, NONREAL ESTATE DEBT, PROBABLY IS A MISNOMER TODAY AS A DESCRIPTION OF THE TYPE OF CREDIT EXTENDED. FORMERLY, NONREAL ESTATE DEBT WAS ASSOCIATED WITH SHORT-TERM PRODUCTION FINANCING OF CROPS, EQUIPMENT, LIVESTOCK, ETC., SECURED BY CHATTEL MORTGAGES BUT NOT REAL ESTATE COLLATERAL. IT HAS BECOME A FAIRLY COMMON PRACTICE FOR SHORT-TERM LENDERS TO TAKE A REAL ESTATE MORTGAGE AS BACK-UP COLLATERAL.

AVAILABILITY OF FUNDS AND INTEREST RATE ARE IMPORTANT CONSIDERATIONS IN THE ENTRY OF FIRMS INTO THE CREDIT MARKET. DURING THE 1966-67 CREDIT CRUNCH, THERE WAS PRONOUNCED DECLINE IN FARM REAL ESTATE LOANS BY INSURANCE COMPANIES. IN 1973, WITH AN INVERSE YIELD CURVE AND WHEN SHORT-TERM RATES EXCEEDED LONG-TERM RATES IN THE SECURITIES MARKET, COMMERCIAL BANKS BECAME MORE ACTIVE IN NONREAL ESTATE (PRODUCTION LOANS) LOANS TO FARMERS.

A FEATURE THAT SETS THE FARMERS HOME ADMINISTRATION APART FROM THE USUAL TYPE OF INSTITUTIONAL LENDER IS THE FARM MANAGEMENT COUNSEL ASSOCIATED WITH THEIR LOANS. BY PROVIDING THE CAPITAL AND THE "KNOW-HOW" THE FHA ASSISTS LOW EQUITY BORROWERS TO REACH A

POSITION TO "GRADUATE" FROM THE PUBLIC FUNDS PROGRAM TO CONVENTIONAL PRIVATE LENDERS AS A SOURCE OF CONTINUING CREDIT. UNFORTUNATELY, THE FUNDS AVAILABLE TO THE FARMER HOME ADMINISTRATION DEPENDS UPON AN ANNUAL APPROPRIATION MADE BY THE CONGRESS -- AND, IN THE PAST, FUNDS ARE OFTEN DEPLETED BY MID-YEAR OR SOON THEREAFTER.

REFERENCE HAS BEEN MADE TO THE IMPORTANCE OF INDIVIDUALS (INCLUDING MERCHANTS AND DEALERS) IN FINANCING AGRICULTURE. WE ARE ALL AWARE OF THE AMOUNT OF FUNDS SPENT FOR PRODUCTION INPUTS WHICH ARE FINANCED AS ACCOUNTS RECEIVABLES. IN THE REAL ESTATE CREDIT AREA, SALES CONTRACTS (OFTEN FAMILY AFFAIRS) CONTINUE PROMINENT -- SOME AS ACTUAL LONG-TERM LOANS, AND SOME AS INTERIM FINANCING TO BE SHIFTED TO INSTITUTIONAL LENDERS AS NECESSARY EQUITY POSITIONS ARE ATTAINED.

OVERALL, INDIVIDUALS ARE A WIDELY USED SOURCE OF AGRICULTURAL CREDIT. FREQUENTLY, FARMERS BORROW FROM LANDLORDS, RELATIVES, AND OTHER INDIVIDUALS WITH SURPLUS FUNDS TO INVEST. IN SOME INSTANCES, INDIVIDUALS ARE A SATISFACTORY SOURCE OF CREDIT, PROVIDING EASY ACCESS TO FUNDS ON REASONABLE TERMS.

GENERALLY, HOWEVER, INDIVIDUALS ARE NOT A HIGHLY DEPENDABLE SOURCE OF CREDIT OVER A PERIOD OF TIME SINCE DEATH OR CHANGES IN THE PERSONAL OR FINANCIAL SITUATION OF THE LENDER MAY RESULT IN A DEMAND FOR REPAYMENT ON SHORT NOTICE OR UNCERTAINTY OF FUTURE ADVANCES.

THERE ARE TIMES WHEN LENDERS COOPERATE OR PARTICIPATE WITH EACH OTHER IN PROVIDING THE CREDIT NEEDS OF FARMERS. THE FARM CREDIT ACT OF 1971 ALLOWS PRODUCTION CREDIT ASSOCIATIONS TO PARTICIPATE ON LOANS WITH COMMERCIAL BANKS; AND IN RECENT YEARS, A PARTICIPATION AGREEMENT HAS BEEN CONFIRMED BETWEEN THE FEDERAL LAND BANKS AND THE FARMERS HOME ADMINISTRATION. THIS LATTER PARTICIPATION CAN BE USEFUL -- ESPECIALLY TO YOUNG FARMERS -- IN PROVIDING CREDIT IN EXCESS OF THE USUAL AMOUNT ASSOCIATED WITH EQUITY REQUIREMENTS. SALES CONTRACTS WITH INDIVIDUALS OFTEN ARE MADE WITH THE UNDERSTANDING THAT THE CONTRACT WILL BE PAID BY SHIFTING THE DEBT TO AN INSTITUTIONAL LENDER AFTER A CERTAIN NUMBER OF YEARS.

SO FAR, WE HAVE CONSIDERED SOURCES OF FUNDS FOR THE INDIVIDUAL FARMER. AN IMPORTANT AREA OF

AGRICULTURAL FINANCE IS THE FARM COOPERATIVE --
USER-OWNED ORGANIZATIONS WHICH PROVIDE SAVINGS
TO THE INDIVIDUAL FARMER-MEMBER THROUGH ECONOMY
OF SIZE AND ADVANCED MANAGEMENT TECHNIQUES.
IN ADDITION TO ACTUAL CREDIT COOPERATIVES (AS THE
FARM CREDIT SYSTEM), OTHER COOPERATIVES OFTEN
PROVIDE CREDIT SERVICES TO MEMBERS THROUGH ACCOUNT
RECEIVABLES, ETC.

CREDIT SOURCES TO THE COOPERATIVE ORGANIZATION
ITSELF INCLUDE COMMERCIAL BANKS AND THE BANKS FOR
COOPERATIVES OF THE FARM CREDIT SYSTEM. DUE TO THE
SPECIALIZED NATURE OF COOPERATIVE FINANCING, LENDERS
TO COOPERATIVE ORGANIZATIONS MUST, IN THEMSELVES,
BE RATHER SPECIALIZED -- THUS IT IS ESTIMATED THAT THE
BANKS FOR COOPERATIVES OF THE FARM CREDIT SYSTEM
ARE CURRENTLY SUPPLYING ABOUT 65 PERCENT OF THE CREDIT
NEEDS OF FARMER COOPERATIVES IN THE UNITED STATES.

FROM THE BORROWER'S VIEWPOINT: WHAT DOES HE LOOK
FOR IN A LENDER AS A SOURCE OF AGRICULTURAL CREDIT?
WE CAN BEGIN WITH CHARACTER -- THE LENDER'S REPUTATION
FOR FAIRNESS AND HONESTY. DOES THE LENDER UNDERSTAND
AGRICULTURE AND ADAPT CREDIT TERMS TO CROP SEASONS,
DEPRECIATION SCHEDULES, PERMANENCE OF ASSETS? ARE
THERE PROVISIONS IN LOAN POLICIES AND REPAYMENT

SCHEDULES TO ALLOW FOR ABNORMAL PRICE CHANGES, SEVERE WEATHER, AND OTHER FACTORS OVER WHICH THE BORROWER HAS NO CONTROL? AND -- VERY IMPORTANT-- WILL THE LENDER BE ABLE TO PROVIDE FUNDS IN A DEPENDABLE FASHION OVER PERIODS OF ECONOMIC STRESS? WHAT IS THE LENDERS SOURCE OF FUNDS?

SO FAR, WE HAVE DISCUSSED THE SOURCES OF FUNDS IN AGRICULTURE -- NOW LET'S CONSIDER THE USES OF FUNDS. TO BEGIN, IT WOULD BE RATHER ACADEMIC TO SAY THAT FARMERS NEED FUNDS FOR FERTILIZER, FEED, TO PURCHASE THE ADJOINING 80 ACRES, ETC. PERHAPS A BETTER APPROACH TO USES OF FUNDS IN AGRICULTURE ARE THE DECISIONS THAT FARMERS MUST FACE IN DECIDING TO BORROW MONEY.

AGAIN, WE ARE CONFRONTED WITH THE QUESTION: ARE FUNDS AVAILABLE? IF SO, AT WHAT PRICE? IT HAS BEEN MY OBSERVATION, OVER THE PAST 20 YEARS, THAT THE FIRST QUESTION IS MORE IMPORTANT THAN THE SECOND. AS A BUSINESS ORGANIZATION INCREASES ITS DEPENDENCE ON CREDIT FOR SUSTAINED GROWTH -- EVEN THOUGH THE USE OF CREDIT IS SOUND -- THE ABILITY TO SHIFT TO A CASH BASIS LESSENS ALMOST TO THE POINT OF DISAPPEARANCE. THIS PHENOMENON IS NOT PECULIAR TO THE FARM BUSINESS.

FOR EXAMPLE -- ONLY A FEW YEARS AGO -- IN THE FEDERAL LAND BANK OF NEW ORLEANS, BONDS OUTSTANDING REPRESENTED 80 PERCENT OF THE LOAN VOLUME. TODAY, THIS FIGURE IS 90 PERCENT -- DUE TO THE RAPID GROWTH IN LOANS OUTSTANDING -- AS FARMERS USE MORE AND MORE CREDIT. TAKEN ANOTHER WAY, THE ACCUMULATION OF RETAINED EARNINGS CONTINUES TO DECLINE AS A SOURCE OF FUNDS IN AN EXPANDING INDUSTRY. SO, THE FARMER IS FIRST CONCERNED ABOUT THE SUPPLY OF FUNDS AND, ONLY SECONDLY, IS HE CONCERNED ABOUT PRICE (INTEREST RATE). .

THIS DOES NOT MEAN THAT THE FARMER IS ALWAYS LOCKED IN -- AT THE MERCY OF THE LENDER. WHILE HIS DEPENDENCE ON CREDIT CONTINUES TO GROW, IT IS NOT NECESSARILY 100 PERCENT, AND HE HAS CHOICES IN (1) TYPE OF CREDIT, (2) LENDERS, (3) TO EXPAND, ETC. I BELIEVE THAT THE TYPE OF CREDIT SHOULD BE RELATED TO THE TYPE OF ASSET FINANCED -- FROM THE STANDPOINT OF TERM, REPAYMENT SCHEDULE, COLLATERAL, ETC. THE CHARACTERISTICS OF A SUITABLE LENDER HAVE ALREADY BEEN OUTLINED; THEREFORE, WITH ALL THINGS BEING EQUAL, THE FARMER SHOULD CONSIDER DIFFERENCES IN INTEREST RATES

(IF ANY) CHARGED BY RESPECTIVE LENDERS. ALSO, THE TYPE OF INTEREST RATE PROGRAM IS IMPORTANT -- FOR EXAMPLE: IS THE BORROWER WILLING TO ACCEPT A VARIABLE INTEREST RATE?

DECISIONS TO EXPAND -- TO BUY THE ADJOINING 80 ACRES -- INVOLVE THE SEVERAL CHOICES ALREADY MENTIONED -- PLUS MARKET PRICE. CAN A PERSON REPAY A LOAN TO PURCHASE LAND AT \$800 PER ACRE AT 8 PERCENT INTEREST? THIS MEANS \$64 PER ACRE AS "MONEY RENT" BEFORE ANY PRODUCTION INPUTS ARE ADDED? AND WHAT ABOUT REPAYMENT OF PRINCIPAL -- THE AMOUNT TO BE ADDED EACH YEAR CERTAINLY WILL VARY WITH THE TERM OF THE LOAN.

EARLIER, IN THIS PAPER, THERE WERE CITED BALANCE SHEET ITEMS FOR U. S. AGRICULTURE -- INDICATING A FINE EQUITY POSITION. THIS CAN BE A PITFALL FOR THE INDIVIDUAL FARMER. WITH THE CONTINUED -- AND OFTEN RAPID -- INCREASE IN LAND VALUES, A FARMER'S EQUITY POSITION CAN IMPROVE "OUT-OF-PROPORTION" TO INCOME AND DEBT REPAYMENT CAPACITY. THUS, IN MAKING THE DECISION TO FINANCE HIS OPERATION WITH BORROWED FUNDS, THE WISE FARMER MUST LOOK BEYOND THE BALANCE SHEET. HE CANNOT REPAY DEBT WITH EQUITY-- UNLESS HE SELLS THE ASSETS.

SOURCES OF FUNDS, CHARACTERISTICS OF LENDERS,
TYPE OF LOANS, BORROWERS DECISIONS -- ALL PART OF
THE CREDIT SCHEME WHICH PROVIDES THE BULK OF
FINANCING IN AGRICULTURE. SUPPOSE THERE IS A
COMMON VIEWPOINT BETWEEN BORROWER AND LENDER --
AS SHOULD BE TRUE IN COOPERATIVE ORGANIZATIONS --
THAT CREDIT SHOULD BE "SOUND" TO BOTH PARTIES. ON
THE CORNER OF MAGNOLIA AND PALMETTO STREETS (FICTITIOUS)
IN NEW ORLEANS IS THE FRIENDLY LOAN COMPANY
(FICTITIOUS). THE COMPANY HAS BEEN IN BUSINESS AT
THIS LOCATION FOR 40 YEARS AND, APPARENTLY, WILL BE
FOR ANOTHER 40. OVER THE YEARS, MANY ACCOUNTS HAVE
BEEN WRITTEN OFF BUT AT 3.5 PERCENT PER MONTH THE
OVERALL CREDIT POSITION IS "SOUND" FOR THE COMPANY --
BUT HOW ABOUT THE UNFORTUNATE INDIVIDUAL WHO HAS
NO CHOICE BUT TO BORROW AT 39* PERCENT PER ANNUM?

FINALLY, AS THIS PAPER IS BEING PREPARED, CONCERN
IS DEVELOPING IN THE FINANCIAL ARENA ABOUT THE
POSSIBILITY OF ANOTHER CREDIT CRUNCH. THIS IS NOT
SURPRISING WHEN ONE LOOKS BACK OVER THE PAST 18 MONTHS
OF UNBRIDLED INFLATION. HOPEFULLY, A SOLUTION CAN
BE FOUND IN REDUCED UNPRODUCTIVE SPENDING. ONE WAY

*State Limit

TO CURE A PORTION OF OUR ECONOMIC ILLS IS TO
ASSURE ADEQUATE FUNDS TO AGRICULTURE -- A PRODUCTIVE
INDUSTRY. I AGREE WITH GLENN BROWNE -- FUNDS
WILL BE AVAILABLE.