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FARM CREDIT PROBLEMS IN THE UNITED STATES WITH SPECIAL REFERENCE TO COUNTRY BANKS

F. L. GARLOCK
BUREAU OF AGRICULTURAL ECONOMICS, WASHINGTON, D.C.

MOST of what is known about country banks has not been published, but consists of the unwritten experience of bankers, supervisory officials and others who are familiar with the practices and policies of bankers and the routine business that passes through banks. There is nowhere a body of published materials which describe the conditions of banking in various parts of the country and the experience with different loan policies.

In their efforts to appraise the banking facilities of farmers, agricultural economists have been handicapped seriously by the lack of explanatory materials. To pass judgment on the quality of banking service one should know what types of business are conducted by banks in given areas and what hazards are involved in the various phases of their business. The studies that have been concerned with country banks have thrown little light on these points.

My task in discussing the subject of country banking is therefore a difficult one. It has seemed best to present some of the results of past research and consider the probable meaning of these findings in terms of banking practice and farm welfare. The latter undertaking is accompanied by a good many hazards, but my intent is merely to suggest lines of inquiry that may prove useful in future research.

Both research and casual observation have shown that the credit needs of farmers are of many varieties, ranging in purpose from production loans to loans for medical service and vacations, and in time, from a few days to many years. Likewise, it is well understood that farmers in this country have access to a wide range of credit facilities. They can borrow directly from local state or national banks and trust companies, the smaller mortgage companies, livestock loan companies and agricultural credit corporations that are located in their communities. They can negotiate loans through the local agents of distant insurance companies, joint stock land banks, mortgage banks, livestock loan companies and agricultural credit corporations, and through the national farm loan associations which secure business for the federal land banks.

Their paper is accepted by banks in the large commercial centers, federal reserve banks, and federal intermediate credit banks, providing it has the endorsement of a local bank or agricultural credit corporation. In addition, farmers make purchases on credit from many commercial concerns, borrow extensively from each other, and frequently are the recipients of direct government loans. One of the first questions to arise is, where do country banks—the local state and national banks—fit into the farmers' financial scheme?

In seeking to obtain loans, farmers find a high degree of specialization in the operations of the financial institutions. Federal and joint stock land banks, insurance companies and mortgage companies as a rule accept only first real estate mortgages at conservative valuations, and their advances ordinarily have maturities of more than three years. Agricultural credit corporations and livestock loan companies specialize in short term production loans secured by chattel mortgages and crop liens. The federal reserve banks, federal intermediate credit banks and commercial banks in the large centers accept farm paper only when it is endorsed by some responsible local institution, and they have varying requirements as to the purposes for which the proceeds of loans may be used. Usually their advances bear short maturities and often they must be secured by collateral. Not one of these institutions makes a practice of handling unsecured loans without endorsement or loans secured by junior liens on real estate. Only a few of them accept loans secured by chattel mortgages and crop liens, endorsed or unendorsed.

Here, then, appears to be the field of country banks. Of all financial institutions, they are the only ones that lend extensively and directly on unsecured obligations. They are the chief market for paper secured by chattel mortgages and often they hold paper secured by junior real estate mortgages. Some of them have large amounts of first real estate mortgages. In general, the loans of country banks are those which cannot command an outside market, although there are many exceptions to this rule in the case of the first real estate mortgage loans.

It does not follow from this that the business of country banks is particularly hazardous. Because they are in close contact with their borrowers, country banks can make safely a class of loans that would prove extremely hazardous for distant institutions. In most cases, also, they select the best of the local loans that are not placed with outside agencies, and leave the poorer risks to merchants, dealers and private lenders. Nor does it follow that country bank loans are used exclusively or even principally for purposes of current production. There is some evidence, which will be presented later, that the composition of the loan accounts differs widely from bank to bank and from area to area. It seems much safer to think of country banks as institutions that deal chiefly in a class of business which does not have direct access to outside markets. Since this class of farm paper is large, it is of much concern to farmers that their banks remain solvent and are operated in the interest of agriculture.

How far country banks can go in meeting the loan requirements of their customers is determined mainly by the volume, character and behavior of their liabilities. Bankers generally feel that their loans should be restricted to an amount which can be supported by the funds supplied by depositors, but if these funds prove temporarily inadequate, bankers often borrow from other banks or rediscount some of their paper. There have been very few analyses of bank liabilities, but, such as they are, they indicate a number of differences among banks which seem to have an important bearing on farm finance.

One of the most striking of these differences is found in the seasonality of the deposits. In some areas, notably those which emphasize the production of a single product such as wheat, potatoes or cotton, the deposits are subject to tremendous seasonal changes in volume, while in highly diversified areas the deposits are nearly constant throughout the year. But time and savings deposits seem to be much less responsive to seasonal forces than demand accounts, so that in any given area the changes in total deposits bear a close relationship to the proportionate amount of demand accounts.

It seems obvious that the lending policies of banks must be greatly influenced by the seasonality of their deposits. When, as is the case with some banks, the deposits increase as much as several hundred per cent during a few weeks at harvest time, fall rapidly as the accumulated debts of customers are paid, and then continue to fall at a moderate rate as the production season advances, there is little doubt that a large part of the peak fund should be invested in commercial paper or call loans, which can be disposed of or collected at short notice. It is equally apparent that banks having moderate seasonal changes in their deposits can safely invest most of their funds in local paper, for with them the requirements of liquidity are not so great.

These conclusions find their support in the underlying conditions with which country banks have to deal. Immediately after harvest in one-crop areas, farmers receive a considerable part of their year's income. It is the receipt of this income which causes bank deposits to rise rapidly, and farmers at this time are in possession of the funds with which to pay off their production credits. They should have little need to borrow immediately after harvest, hence the investment of bank funds in call loans or commercial paper at this time is not detrimental to their interests, and is, in fact, one of a very few employments for the funds that will not be detrimental to their interests. Farmers in diversified areas, on the contrary, receive their incomes at more frequent intervals and their expenditures are distributed more evenly throughout the year. Neither the receipt of income nor the demand for loans is as concentrated in given seasons as in one-crop areas. The income deposited by some farmers offsets the funds withdrawn by others and loan payments by some farmers enable the banks to lend to other farmers. Banks in diversified areas do not have the surpluses and deficits common to one-crop areas.

Still a further inference is to be drawn from these varying conditions. It seems certain that a given loan fund which revolves almost continuously among local farm borrowers in a diversified area will satisfy as large a volume of local production demands as a much greater fund which in one-crop areas is used in some seasons for local loans and in other seasons for outside investments. Banks in diversified areas, consequently, should be able to employ more of their lending power in making capital advances than would be feasible for banks in one-crop areas.

From this point of view, country banks in the United States appear, not as highly standardized institutions, but as institutions whose business in each case is adjusted closely to the peculiar conditions existing in the local community. All factors which affect the receipt and expenditure of income and the accumulation of wealth in a community exert an influence on the liabilities of local banks and the local demand for loans. Some country banks have relatively constant deposits, consisting chiefly of time and savings accounts, and loans which represent principally advances for fixed capital uses. Others, in poorer areas, have to contend with tremendous seasonal changes in their deposits and find it difficult to meet even the production credit requirements of their communities. Obviously different standards of judgment should be applied to the practices of banks operating under these widely divergent conditions.

Not only are there vast differences among banks in the character of their business, but there are also great differences in the hazards or risks which the banks assume. From some points of view, the one-crop areas seem to involve the greatest risks in banking. Here the injurious effects of price declines, bad weather, and pests are at a maximum so that in poor years the volume of deposits falls to low levels and the banks have great difficulty in collecting their production loans. On the other hand, good years produce a greater abundance of deposits in one-crop areas than in diversified areas, and the temptation to over-expand loans reaches a maximum. With the more even course of business in diversified areas, there is less danger of over-expanding loans in good years and less need to contract them in poor years. From this it follows that banks in diversified areas should be able to render a more constant and reliable service than those in one-crop areas.

But there is another angle of this problem which is much more difficult to appraise. By force of circumstances banks in one-crop areas are not able to involve themselves nearly so deeply in fixed capital advances as are banks in highly diversified areas. To meet the great fluctuations from season to season and year to year in the local demands of depositors and borrowers, they have to maintain a highly liquid position. While these great year to year changes are a nuisance and involve special hazards, it is a question if the liquidity of loans which they engender is not a protection against longer time downward trends in property values, such as the decline of land values that has been in force since 1920. Banks whose loans have been based on equities in land in many cases have found it impossible to protect these advances. They consequently have become insolvent in spite of the fact that their ability to meet current demands was not seriously impaired. Risks of a similar character arise in one-crop areas, of course, when there are successive crop failures year after year.

The differences among country banks that have been suggested in the preceding discussion are further evidenced by the variations known to exist in rates charged on bank loans to farmers. These rates are highest in the southern and mountain states and lowest in the northeastern states. Other points have intermediate rates. Banks in the northeastern states have tremendous accumulations of time and savings deposits and their total deposits are further stabilized by the influence of industrial activity. Banks in the central states have also large accumulations of time and savings deposits and their agriculture is well diversified. In the southern and mountain states there generally are much smaller proportionate accumulations of time and savings accounts and there is less diversification in agriculture.

The conventional explanation of sectional differences in rates on bank loans is that the rates are determined by the costs and risks of banking. In support of this conclusion a few studies have shown that the unit costs of banking and the percentage losses on assets have varied in close conformity with the rates. Also, the preceding discussion suggests that there are wide differences in the character of the business of banks in different parts of the country, which might be sufficient to explain the variations in the bank rates.

Some known factors, however, cause one to doubt if the line of causation is as clearly defined as has usually been thought. It is known, for instance, that many country banks have a customary lending rate which is applicable to a large proportion of their loans and which year after year remains unchanged. In a remarkable number of cases this customary rate is the legal rate of the state in which the banks are located. It is known also that when these banks come into possession of more funds than are needed to meet the home demand, they usually invest the surplus in outside paper bearing low rates rather than attempt to increase local demand by reducing their customary rate. These facts raise the question if custom and legislation do not often determine the rates, and the rates, in turn, determine the costs and the risks that are assumed by the banks.

Reference is made here solely to what banks designate as their customary rate. This rate does not apply to all borrowers or to all classes of loans. In areas where farm mortgage loan institutions are active, the banks find it necessary to lower their rates on such loans as are affected by the competition of these institutions. There always are some borrowers, moreover, whose accounts are so valuable to banks that they are granted preferential rates. Customary rates apply to the general run of customers whose accounts are of no more than ordinary value and who do not have access to outside institutions with lower rates. This class, however, includes the majority of borrowers in many banks.

Time permits me to mention only one more problem. Of the many that remain unsolved, the question of country bank failures undoubtedly is most important. Since 1920 several thousand country banks have been forced to close, and in seven agricultural states, more than 40 per cent of all the banks operating in 1920 have failed. The loss to farmers resulting from these failures has been far and beyond the amounts reflected by the claims that have not been paid.

The studies that have been concerned with bank failures have produced very little information that can be used as a prevention in the future. It is clear that the difficulties of agriculture have been responsible to a large extent for bank failures, but the way to agricultural prosperity has not yet been lighted. Also, although little has been made public on this point, it is quite certain that prior to 1920 banking regulation in many states was of an exceedingly casual character, and that bankers had become careless as a result of many years of prosperity. While some progress has been made in improving bank regulation, the specific character of the reforms needed is still a matter of uncertainty. Bankers undoubtedly have learned much since 1920 that can be put to good use, but there is little or nothing in the written records to tell what this is and to serve as an element of protection when the next generation of bankers takes up the reins.

What farmers want is a banking service that is well adapted to their needs, that is rendered at reasonable cost, and that will not add to their difficulties by breaking down in times of agricultural depression. Except for figures on the number and distribution of bank failures, agricultural economists at present have no information of a character to indicate how well these requirements have been satisfied. Nor will they have such information until detailed studies of the original records of banks and farmers in representative areas of the country have been made. Just how these studies should be conducted is a matter that time and experience alone can decide. My effort has been merely to indicate the character of the problems of country banks and to hazard a few guesses as to the differences that will be found among them.