

TEN YEARS OF FEDERAL
INTERMEDIATE
CREDITS

BY
FRIEDA BAIRD
AND
CLAUDE L. BENNER

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DIRECTOR'S PREFACE

In 1926 the Institute of Economics published a book entitled *The Federal Intermediate Credit System* prepared by Claude L. Benner, one of the authors of the present volume. This study dealt with the Agricultural Credits Act of 1923, which was just then getting into operation. Obviously it was necessary at that time to set a limited objective upon our analysis of this new credit development. The author confined himself to discussion of the historical background of the Act, its general philosophy, the structure of the credit agencies which it proposed to set up, and the issues which apparently would arise in the administration of the system.

Some five years after the passage of the Agricultural Credits Act of 1923 the Institute began a systematic study of actual results attained in operation. Through careful study of available statistics, supplemented by a considerable amount of field work, the senior author of the present volume has gained an intimate acquaintance with trends of development and the emergence of issues and problems as the several parts of the system have evolved. This permits a much more definite appraisal of the Federal Intermediate Credit system than was possible in the days of its infancy. In particular it makes it possible to show the relation of so-called "intermediate credits" to the general field of agricultural finance. The initial chapters of the book contain in condensed form most of the background material from Dr. Benner's earlier book.

We feel that the present is an opportune moment for the presentation of the results of such a study. The Intermediate Credit system had its birth in the period of

agricultural distress which followed the depression of 1920. Other outgrowths of this period of distress have been the Federal Farm Board and recently the Reconstruction Finance Corporation. Both have undertaken important credit functions with reference to agriculture. While they are to be regarded as agencies of an emergency character, we shall in the near future face the problem of bringing agricultural credit from this stage of emergency treatment to some more permanent basis and of co-ordinating our several rural credit agencies for the future service of the agricultural industry. Such is the task assigned to the Farm Credit Administration which will begin operations on May 27, 1933.

Inasmuch as we stand, apparently, at a parting of the ways with reference to the future of farm finance, it is important that we bring together and interpret the facts developed in the experience of the Intermediate Credit system during the ten years from its inception down to the present time. Only in this way can a sound foundation be provided for important decisions which must be made during the next few years.

Harold G. Moulton and Charles O. Hardy served with the director as a committee co-operating with the authors in the preparation of this volume.

EDWIN G. NOURSE
Director

Institute of Economics
April 1933

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If the authors have succeeded in presenting a reasonably complete picture of the varied phases of the Intermediate Credit system it is due to the generous assistance of the officers and employees of the Columbia, Omaha, and St. Louis Intermediate Credit Banks, which were visited in the course of this study, and the willingness of executives of the other banks to furnish comparable data and to answer numerous inquiries by correspondence. Likewise the managers and officers of local credit corporations and co-operative marketing associations gave freely of their time and in many cases opened their records for examination.

The Statistical Division and the Intermediate Credit Banks Division of the Federal Farm Loan Bureau have supplied information in a form most useful for the purposes of this study. In addition to furnishing necessary data, officers in charge of these divisions made helpful suggestions which enabled the writers to avoid errors that otherwise might have occurred.

Several chapters were read by specialists in the field who offered pertinent and constructive criticism. Commercial bankers, officers of the Federal Farm Board, members of the Department of Agriculture, and many other persons have furnished material and clarified certain aspects of the problem. Because of their business affiliations or official positions it is not always appropriate to make personal mention of those who have been extremely generous with their time and suggestions. The authors are deeply grateful to all who have rendered assistance.

FRIEDA BAIRD
CLAUDE L. BENNER

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TEN YEARS OF
FEDERAL INTERMEDIATE
CREDITS

INTRODUCTION

At no time in our history have the credit needs of any industry received so much attention as have those of agriculture during the past two decades. From the passing of the Federal Reserve Act in 1913 to the Agricultural Credits Act of 1923 almost steady attention has been paid to some phase of the rural credit problem in both state and national assemblies. This attention has borne fruit in the enactment of a large amount of new legislation and in the establishment of two federal systems of rural credit institutions. Beginning with the liberalization of the powers of the national banks to make farm loans and the special agricultural provisions of the Federal Reserve Act, this movement has grown until now we have the Federal Land Banks, the Joint Stock Land Banks, the Intermediate Credit Banks, National Agricultural Credit Corporations, discount corporations, and numerous agencies for lending state funds to agriculture. In addition, a farmer member has been placed on the Federal Reserve Board, and there has been an important broadening in the discount powers of the Reserve Banks in respect to all agricultural paper.

While one could say in 1912 with some degree of truth that we were the most backward country in the Western World in the matter of rural credit facilities, this is certainly not the case today. No other single industry in the country has so many types of credit institutions to serve it. In addition to being free to call upon all the institutions that serve manufacturing and commerce, agriculture has two special credit systems of its own. During the severe agricultural depression of

1920-21 the farmers' spokesmen were certain that what agriculture needed to restore it to prosperity was more credit. As a result the Federal Reserve Act was amended, the Federal Reserve Board reorganized, the powers of the Federal Land Banks enlarged, and a new system of banks established to take care of the so-called intermediate credit needs of agriculture.

This last rural credit legislation took place within such a short time and during so much storm and stress and under such abnormal economic conditions that at the time the laws were enacted Congress was almost taking a leap in the dark. No consensus of opinion could be obtained as to the kind of credit legislation that was needed to make our banking system meet the requirements of agricultural production. Nevertheless the 67th Congress was forced by political pressure to pass some kind of rural credits law, and consequently in the very closing hours of its last session the Agricultural Credits Act of 1923 was rushed through.

The opponents of this measure both before and after its passage were free with dire prophecies that the Federal Reserve system had been ruined, that a new system of banks had been established under such conditions that it would be able to drive the regular banks out of business, and that a general credit inflation would result. On the other hand the advocates of the Act made glowing promises as to the benefits that would result to agriculture when these new credit institutions were once established. Conservative students of banking both within and without Congress freely admitted when the Act was passed that they did not know what changes it would make in our financial organization. More than a decade has elapsed since this legislation was enacted. This

period, although comparatively short, has given us a basis for evaluating our Intermediate Credit system. Loans have been made, policies tested, and certain factors of success and failure revealed. While recognizing the limitations which a short-term view imposes, we believe that the Intermediate Credit system in its formative period offers significant features for study which may be overlooked or become less distinct with the passage of time.

In addition to the shortness of the experience which we have had with intermediate credits, the passage of the Agricultural Marketing Act and the creation of the Federal Farm Board have introduced new elements into the situation which make confident prediction of future developments difficult. However, before the federal government attempts either to re-shape existing short-term credit institutions to meet the needs of agriculture or to develop other facilities, it is well to examine the credit mechanism which has been established and to analyze the experience of the Intermediate Credit system as a going concern with the hope of determining both its merits and its shortcomings.

It is the purpose of this study therefore (1) to explain the causes which gave rise to the passage of the Agricultural Credits Act of 1923; (2) to describe the structural growth of the new credit mechanism; (3) to review the operating experience of the local agencies and the discounting banks in providing the variety of loan services they are authorized to furnish; (4) to bring into clear relief the issues that have been raised and problems that remain to perplex; and (5) to evaluate the place which our Intermediate Credit system has in our banking and credit structure.

Only a brief discussion of the proposed Farm Credit Administration is attempted inasmuch as the executive order providing for it was announced after this study had gone to press. Moreover, the order will not become effective until May 27 and as yet only tentative plans have been announced. Nevertheless, a comprehensive reorganization of our agricultural credit facilities makes it more imperative than before that we understand and appreciate the problems confronting an agricultural banking system which finances agricultural producers and their co-operative associations. Familiarity with the operating experience of the Intermediate Credit Banks should contribute to such an understanding.

PART I

ORIGIN AND CHARACTER OF THE
AGRICULTURAL CREDITS ACT

CHAPTER I

ECONOMIC ROOTS OF THE PROBLEM

The agricultural finance problem is not a new one in the United States. In a very real sense certain aspects of this problem have been with us since Colonial days. The Colonies, predominantly agricultural, petitioned King George III for permission to print paper currency because they felt the need of more money to carry on their operations. Later, during Jackson's administration, the movement for the organization of small state banks and the "era of wild-cat banking" were manifestations of a similar desire on the part of the expanding agricultural West. Again after the Civil War, when the farmers found themselves once more in financial straits, they advocated the printing of more greenbacks as a solution of their ills. Still later, in 1896, it was the hard-pressed farmers of the South and West who gave strength to the campaign for free silver.

It is always in periods of economic distress that the weaknesses and defects of financial institutions are perceived and even exaggerated. These successive periods of agricultural distress were productive of significant reforms in agricultural financing agencies. However mistaken some of the farmers' demands may have been, out of them grew eventually some very sound reforms of mortgage credit agencies and marked improvement in the services that the commercial banking system offered the rural communities. But in spite of these improvements, when the depression of 1920-21 struck agriculture there soon developed a new agitation with the words "intermediate credit" as its rallying cry. The

spokesmen of this movement pointed out that, while the mortgage and short-time credit needs of agriculture had been well taken care of, there was still a "barren area" between these two fields in which the farmer had no institutions to serve him. This "barren area" consisted of the credit needs of agriculture for loans running from six months to three years—intermediate credit, as it soon came to be called. Here it was insisted that the farmers needed a better service and the establishment of new institutions to render it. In order to understand the emergence of this new demand and to see what merit there was in this contention, we must first go back for a brief survey of the evolving credit needs of agriculture and of the development of the credit institutions that were designed to meet them.

I. CHANGING CHARACTER OF OUR AGRICULTURAL INDUSTRY

It was not until about the last quarter of the nineteenth century that farmers in the United States had any considerable need for borrowing to finance farm production and crop distribution. In fact such borrowing as was necessary to secure a farm was small, as land was either free or could be bought at low prices. Under the extensive system of agriculture that prevailed during the era of cheap land the outlays for fertilizer, labor, and farm machinery were small, and practically the only use that was made of credit was to purchase the family supplies during the crop-growing period.

How these needs, at first small but later expanding with great rapidity, were taken care of more or less adequately by stores, country banks, and other agencies will be shown in the next section. First, however, we must examine in detail the character and growth of the credit

needs which got under way during the later decades of the nineteenth century and proceeded at a rapid pace after the opening of the twentieth.

Toward the close of the nineteenth century, agriculture in the United States was entering upon a new era. The day of abundant free land had at last passed into history and our agricultural production could no longer be expanded by the simple method of putting more acres of virgin soil under the plow. At the same time a world whose population was constantly increasing, and whose industrialization was progressing at a rate never seen before, was making increased demands for agricultural products. Farmers were thus placed in a favorable economic position. From 1900 to 1920 the prices of their products constantly rose. These higher prices furnished an incentive for increased production. However, an increase in agricultural output after the passing of free land could only be accomplished by adopting more intensive methods of cultivation. And more intensive methods of cultivation called for larger expenditures of capital. Here is our point of departure for a study of intermediate credit in agriculture.

This changed agricultural situation is clearly revealed in the census figures for number of farms and improved land in farms at successive census dates. From 1860 to 1900 the number of farms increased from 2,044,077 to 5,737,372, an increase of more than 180 per cent. During these 40 years the amount of improved land in farms increased from 163,110,720 acres to 414,498,487 acres, an increase of 154 per cent. But with the opening of the twentieth century this rapid increase began to slow down, and by 1910 it had nearly come to a stop. During the first decade of this century there was an

increase of little more than 10 per cent in the total number of farms, and from 1910 to 1920, in spite of the impetus given by the war, this increase was only 1.4 per cent. The figures for the amount of improved land in farms show this same slackening tendency. From 1900 to 1910 there was a 15 per cent increase, while during the next decade this increase dropped to only 5 per cent.

A decrease in the number of farm workers was a second phase in this agricultural transition. Whereas the slowing down in expansion of land area took place somewhat before the end of the century, there was a lag of some ten years before the parallel check to growth in the number of farm workers took place. While data for comparison are available only for census years, it is probable that the turn of the tide so far as farm workers were concerned came somewhere about 1906. The change from decade to decade is shown in the accompanying table.

The passing of the frontier and the decline in agricultural workers did not cause agricultural output to diminish. Increased production of crops and livestock continued unabated during the two decades following 1900. Moreover, during this time a wide variety of new agricultural products supplemented the old staple crops. Perhaps the most accurate way of measuring what was taking place in our total agricultural output is to be found in the composite index number of agricultural products which has been computed by Edmund E. Day. Using the five-year period 1909-13 as 100, the index number for 1890 stood at 55.8,¹ for 1900 at 80.9, for

¹ This particular year happens to be one of low yield. The index for 1889 was 63.7 and for 1891 was 70.4.

1910 at 99.1, and for 1920 at 115.2. The chart on page 14 shows graphically how the trend of total production continued to mount steadily after the end of the century when expansion of acreage and workers had slowed down. This same conclusion is borne out by figures of the United States Department of Agriculture, which indicate that during the decade 1910-19 the quantity of crops produced increased approximately 13 per cent. During this same period farm workers declined 4.3 per cent in number, but productivity per worker increased.

NUMBER OF PERSONS ENGAGED IN AGRICULTURE, 1880-1920

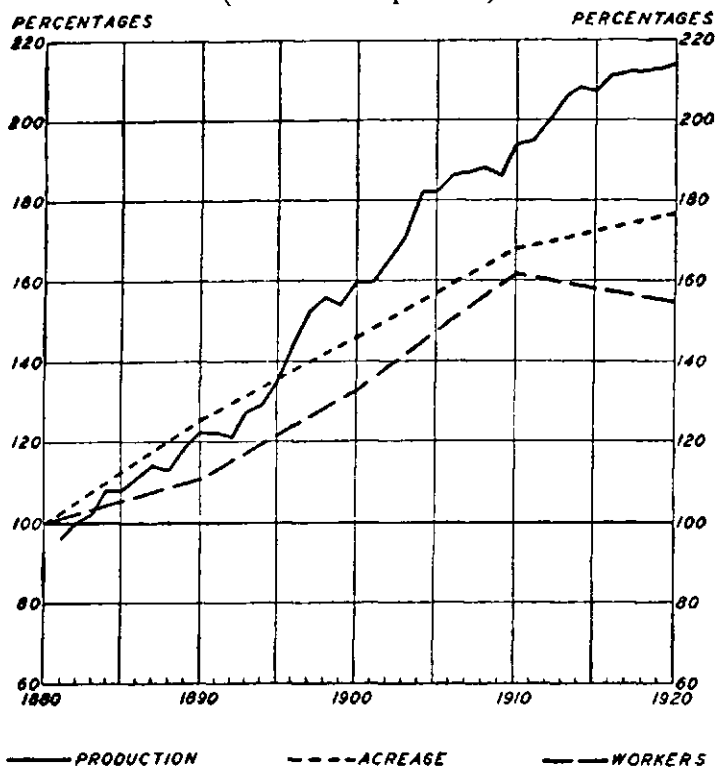
Year	Number of Persons	Change during Decade (Per cent)
1880.....	7,663,043	—
1890.....	8,466,363	+10.5
1900.....	10,249,651	+21.1
1910.....	12,363,702	+20.6
1920.....	11,850,000*	-4.3

* This figure has been adjusted to an April 15 basis making it more comparable with those of previous census years. The unadjusted figure in the Fourteenth Census was 10,446,385, but represented the situation on January 1.

Comparing the crop acres tilled per agricultural worker in the United States for 1910 with the same figure for 1920, we find an increase from 24.6 acres in the former year to 32.6 acres in the latter.

The increased productivity per man and per acre reflects to a considerable extent a growing intensification in our agricultural technique, brought about by a more liberal use of capital. During this period larger buildings were erected, more and better livestock was kept, new fences were built, soil was better prepared, and crops were more carefully tilled. Thus the capital ex-

COMPARISON OF INCREASE IN AGRICULTURAL PRODUCTION,
IMPROVED LAND IN FARMS, AND NUMBER OF
AGRICULTURAL WORKERS, 1880-1920^{*}
(1880 = 100 per cent)



^{*} The production index is a five-year moving average based on annual indexes of the physical volume of production computed by Edmund E. Day; see *Review of Economic Statistics*, 1920, Preliminary Vol. II, p. 255. Indexes for improved land in farms were computed from U. S. Census figures while those for agricultural workers were based on the U. S. Department of Agriculture's revision of census figures.

penditures necessary for the production of crops and the maintenance of livestock increased. As a result we find that the expenditures for labor, feed, fertilizer, and

farm machinery all mounted rapidly during these two decades.

The increase in the value of livestock was also very marked. Census figures show that the total value of animals on farms in 1880 was 1.6 billion dollars. It rose during the next ten years to 2.3 billions, and at the close of the century it had reached 3.1 billions. From this point on, the increase was even more rapid. In 1910 the total value was nearly 5 billion dollars, and in 1920 it was well over 8 billions. These last 20 years were a period when the quality of our livestock, especially dairy cattle, underwent a marked improvement.

A more liberal use of farm machinery contributed to a considerable extent to the increased efficiency of our agriculture. The census reports show that the value of farm implements and machinery per acre of improved land, which had remained quite stationary since the Civil War, began to increase at the close of the century. In 1890 this figure stood at \$1.38 per acre, in 1900 it was \$1.81, in 1910 it had increased to \$2.64, and in 1920 it had advanced to \$7.15. The increase during this period was not merely one of value. The Department of Agriculture estimates that quantitatively the increase in the use of farm machinery during the first 20 years of this century was 46.7 per cent per acre of crops tilled.² This was a period when the number and kinds of farm implements were being greatly increased. Side-delivery rakes and hay loaders were taking the place of the old dump-rake and pitchfork; improved sulky plows and two-row cultivators were replacing the old walking plow and the one-horse cultivator. Tractors, motor trucks, gasoline engines, and automobiles

² See *The Agricultural Situation*, U. S. Department of Agriculture, 1924, Vol. V, No. 6, p. 13.

were also coming into more general use. The Census of 1920 found that there were 2,146,362 automobiles, 246,083 tractors, and 139,169 motor trucks on farms. The rise in the values of farm implements and machinery from \$749,775,970 to \$3,594,772,928 during the two decades from 1900 to 1920 shows how rapidly the capital factor in agricultural production was increasing in importance during this time.

The capital outlays made for the purchase of fertilizer show this upward trend even better than do those for machinery. The days when farmers could raise abundant crops by simply scratching the surface of the soil and scattering the seed over the top are gone forever. Today even that part of our country which is the richest in soil fertility, namely, the Corn Belt, has begun the use of commercial fertilizer, while for the farmers of the East and the South its use has become so general as to be considered a regular part of the farmer's annual outlay. According to the Census of 1880 the total cost of commercial fertilizer used on farms was 28.6 million dollars. Since then there has been an increasing outlay for this purpose. In 1910 it was reported as 114.9 millions, an increase of 110 per cent over 1900; while in 1920 the total cost had mounted to 326.4 millions, an increase of 184 per cent over 1910 and 1,042 per cent over 1880. No other factor shows the changing character of our farm production better than the growth of these expenditures for commercial fertilizer.

The growing commercialization of agriculture necessitated increased cash outlays for labor. In the early days the capital outlay which the farmer had to make for labor was not significant. The Department of Agriculture estimates that even at the close of the nineteenth century the wage for farm labor was only \$14.07 per

month. Beginning with 1900, however, farm wages rose rapidly until the agricultural depression of 1920-21. By 1902 the monthly wage had increased to \$15.51; when we entered the war in 1917 it was \$28.64; and in 1920 it had reached \$47.24.³ These figures include board as well as the money wage. Thus in 20 years farm wages had increased more than 300 per cent over what they were at the beginning of the century. The Fourteenth Census reports that the total amount expended for farm labor in 1919 was \$1,356,403,452. This figure had risen in two decades from \$365,305,921, an increase of 371 per cent. Farmers now had a payroll of considerable magnitude to finance. Inasmuch as this expenditure had to be incurred before the farmers had received the cash returns from the labor, it created an additional demand for working capital.

Finally, the keeping of more livestock and poultry required increased outlays for feed. In the main this increased expenditure did not result primarily from larger purchases of raw products such as hay and grains but from additional use of commercial feed stuffs. The growth in the manufacturing of the so-called "mill feeds" for livestock during the past two decades has been very rapid. The Census of 1920 shows that 54.5 per cent of all farms reported an outlay for this purpose, and that the amount spent for feed by farmers in 1919 totaled \$1,097,452,187. In 1909, 37.2 per cent of the farms reported an expenditure for feed, and the total amount spent for this purpose was only \$299,839,857. Farmers, even as manufacturers, were purchasing raw materials in order to turn out finished products.

The commercialization and growth of agriculture

³ *Yearbook of Agriculture*, U. S. Department of Agriculture, 1932, p. 903.

created a rapidly expanding need for ample working capital. The need for machinery, livestock, commercial feeds and fertilizers, and the financing of labor outlays and living expenses created credit demands running all the way from periods as short as a month, through those which covered a crop-growing season, to others—particularly in the livestock industry—which required periods of from one to several years in which to liquidate themselves. Such needs embraced both what are commonly classed as short-time commercial loans and what are often referred to as intermediate credits. The questions that challenge our attention are how these credit needs of both the longer and shorter type were met by the farmers throughout the period, what credit facilities were within their reach, and how these agencies were developing during the period under review.

II. EARLY RURAL CREDIT AGENCIES

The credit needs of agriculture for working capital had been financed since pioneer days in a variety of ways. First, both in time and in importance, was financing upon the basis of land mortgages. It was a common practice to mortgage land for the express purpose of raising working capital. The comparatively strong legal position of such security made it particularly acceptable at a time when the principal sources of credit were to be found in the older and richer sections of the East, remote from the rapidly developing pioneer regions where demand for capital was the most insistent.

Since the financing of production credit on the basis of mortgage security is a cumbersome process, farmers abandon this method whenever other channels are opened for bringing the resources of commercial credit

to their aid. The commission merchant of the large city and the general store proprietor and implement dealer of the small town were first in furnishing such channels. They financed many credit requirements of farmers with funds which they in turn borrowed from banks in the large cities. While there are no data available to show how much credit was afforded to farmers by these agencies, such local studies as have been made indicate that this method of obtaining credit was prevalent in the farming sections of the country where local capital was scarce.⁴ Such means of credit extension, however, were far from satisfactory, and they usually involved high middleman charges.⁵ Whether the farmers borrowed their money outright from merchants, commission men, or factors, or purchased their equipment and supplies on time, they were certain of paying charges for credit secured in this way disproportionate to prevailing bank rates.

A special type of credit institution, the cattle loan company, was established to finance the livestock industry. The large size of the loans and the lack of local credit agencies made it necessary that special credit institutions be maintained for connecting this industry with outside sources of capital. Toward the close of the last century various packer interests and the banks lo-

⁴ Louis H. Haney, "Farm Credit Conditions in a Cotton State," *American Economic Review*, 1914, Vol. IV, p. 50; Meyer Jacobstein, "Farm Credit in a Northwestern State," the same, 1913, Vol. III, p. 598.

For a detailed historical and analytical account of early credit institutions serving the farmer see Earl Sylvester Sparks, *History and Theory of Agricultural Credit in the United States*.

⁵ In this respect the condition of the South was particularly bad. Here a vicious system of store credit with crop lien security was in practice, which usually made the cost of credit to the farmers run from 20 to 40 per cent.

cated in the large stockyard cities began to organize cattle loan companies to extend credit to livestock producers. By the opening of the twentieth century large numbers of these loan companies had been established.

Throughout the eighties and nineties, as population increased and wealth accumulated in the agricultural regions, there was a substantial increase in the number and resources of country banks whose business was developed primarily on the basis of the local farmers' needs. In fact the movement for the establishment and maintenance of small state banks was stimulated chiefly by the desire to furnish banking facilities to agriculture. In order to encourage their organization, Kansas, Nebraska, North Dakota, South Dakota, Oklahoma, and Wisconsin permitted the incorporation of state banks with a capital as small as \$5,000. In practically all the other farming states they could be started with a minimum capital of either \$10,000 or \$15,000. While in 1880 there were slightly more than 800 state banks in the country, 20 years later there were over 4,000; and by 1914 there were approximately 14,500. This increase was by no means uniform throughout the various sections of the country, being particularly rapid throughout the agricultural regions of the West and South.

Also, in order to facilitate the organization of national banks in small communities, the National Bank Act was amended in 1900, permitting national banks with a minimum capital of \$25,000 to be established in communities of 3,000 or less. Prior to this date the minimum requirement of \$50,000 had been so large that it had prevented national banks from being started in agricultural communities. Thus the organization of country banks was stimulated by both state and national legislation. Whatever the wisdom of this legislation

from the point of view of sound banking policy, there is no doubt that the ease with which they could be established made possible the organization of country banks in even the smallest communities. The table below shows how the number of banks increased during the first 14 years of this century in certain agricultural states.

INCREASE IN NUMBER OF BANKS IN TYPICAL AGRICULTURAL STATES
1900-14*

State	1900	1910	1914	Percentage of Increase, 1914 over 1900
Iowa.....	733	1,351	1,558	113
Minnesota.....	316	895	1,108	251
Nebraska.....	506	882	953	88
Kansas.....	483	1,046	1,144	137
North Dakota....	152	671	765	403
South Dakota....	204	599	625	206
Montana.....	42	140	285	579
Oklahoma.....	106	900	916	764
Texas.....	244	1,093	1,421	482
North Carolina...	117	410	474	305
Georgia.....	180	475	798	343

* Figures compiled from reports of the Comptroller of the Currency.

All the evidence seems to show that the growth of country banks, in numbers if not in resources, fully kept pace with the development of agriculture. By 1910 it was unusual to find a hamlet with a population of over 200 without one or two banks. At that time writers were beginning to say that more country banks were being established in certain sections of the country than there was any economic need for.⁶ It was very evident

⁶ Charles M. Harger, "The Farmer and His Bank," *Saturday Evening Post*, Apr. 16, 1910, Vol. 182, No. 42, p. 25.

at the time the Federal Reserve Act was passed that the farmers were not suffering from a lack of country banks. In fact there was reason for believing that more banks had been established than were needed to render an efficient banking service.

In spite of the remarkable growth of country banks, farmers continued to complain that their banking facilities were inadequate. High interest rates, difficulty in obtaining sufficient currency for crop-moving purposes, and inability to secure loans for periods of time suited to their occupations were the chief features of their criticism. These difficulties were not so much due to an absence of local banks as they were to the defective way in which our whole banking system was organized. Our unit banking system, composed of over 25,000 independent banks, was so unorganized that there was not an adequate discount market for commercial paper in the United States. Consequently whenever a bank had loaned up to its reserve limit it was forced to refuse further accommodation to its customers. This worked a particular hardship in the agricultural regions because of the markedly seasonal character of the agricultural demand for loans.

Country banks did not have sufficient connection with outside sources of capital to make them efficient credit institutions. The absence of a wide discount market for commercial paper had its effect upon interest rates, causing them to be high in one part of the country at the same time they were low in another. It was no unusual thing to find interest rates of 10, 12, or 15 per cent in the farming districts of the South and the West, while at the same time there was an abundance of idle funds being loaned out in the large cities of the country

at 3 and 4 per cent.⁷ The test of efficiency of any credit institution is in its ability to bring the borrower and the lender together for their mutual benefit. Our rural banks were unable to do this satisfactorily, and consequently large parts of our country communities, especially those which were newly settled, were inadequately served. The market for agricultural paper was limited, and the country banker frequently had difficulty in bringing in outside funds to take care of the seasonal requirements of his customers. High interest rates and inadequate credit accommodation were the inevitable results of such a banking system.

The complaint that the banks did not extend credit to the farmers for periods of time suitable to the character of the agricultural industry was little manifested except in times of credit stringency. During normal times country banks were in the habit of renewing agricultural loans and in this manner providing the longer term credit which was required. But in times of stringency the farmers frequently had difficulty in renewing their loans. Hence always after such an experience this criticism would be heard. It was primarily this difficulty which caused the agitation which led to the establishment of the Federal Intermediate Credit Banks.

III. THE FARMERS' CREDIT POSITION IN 1920-21

For an understanding of the rural credit agitation which culminated in the passage of the Agricultural Credits Act of 1923 we must look to the changes which the World War wrought in agriculture.⁸ The abnormal

⁷ J. Laurence Laughlin, *Banking Reform*, p. 320.

⁸ For a fuller discussion of this question see Claude L. Benner, "Credit Aspects of the Agricultural Depression, 1920-21," *Journal of Political Economy*, 1925, Vol. XXXIII, pp. 94-106, 217-33.

war demands caused the prices of agricultural products to mount rapidly. Stimulated by the high prices and by fervid appeals to patriotism, the farmers greatly increased their production. Both the intensive and extensive margins of cultivation were extended. So great was the desire to increase production that many unwise ventures were undertaken. Land which was ill-suited for permanent cultivation was put under the plow in the attempt to stimulate the production of crops needed for war purposes.

Our maximum agricultural production was reached in the year 1920. Not only was the acreage of that year near the war-time peak but the yields were abundant.⁹ The number of livestock had increased rapidly in response to war demands, reaching its peak in 1919. A slight decline occurred the following year, but even so the estimated production of meat for that year was only 3.3 per cent less than the preceding year.¹⁰

This scale of production could continue to be profitable only so long as relatively high prices prevailed for agricultural products. In accordance with accepted economic doctrine, the costs of production had rapidly mounted as the margins of cultivation had been extended. Feeling certain that the days of pre-war prices were gone forever, the farmers had adjusted their whole operations to the war-time price level. Standards of living, land values, taxes, expenses of production—all

* The acreage for the five principal cereals in 1920 was below the figure for 1918, but the total crop yield was 5.8 million bushels in 1920 in contrast to 5.3 millions in 1918. The tobacco crop of 1920 was 1.6 million pounds in comparison with 1.4 millions in 1918, while the 1920 cotton crop was 13.4 thousand bales in contrast to 12.0 thousands for 1918.

¹⁰ *Yearbook of Agriculture*, U. S. Department of Agriculture, 1921, p. 76.

were adjusted to this new price level. Then suddenly in the midsummer of 1920 prices began to drop. By the close of the year many of our agricultural products were selling at pre-war prices, and in some cases it was difficult to market them at any price.

Even if agriculture had been expecting a fall in prices and had been fortified to meet it, such a drastic decline as occurred in 1920-21 would inevitably have precipitated a crisis in the industry. The situation was aggravated at this time by the fact that the majority of the farmers were not expecting a decline in prices, and very few of them had taken any precautions to cope with such a condition.

The farmers were heavy borrowers from the banks during the whole period from 1915 to 1920. During the war years, instead of liquidating their bank loans and paying off their mortgages, large numbers of farmers incurred increased indebtedness. This is manifested by the increase which took place in the loans and discounts of the country banks during this period. Such data as we have on the amount of bank loans to farmers show that they increased rapidly. On the basis of a study made in 1915 the United States Department of Agriculture estimated that the banks had outstanding to farmers, loans on personal and collateral security to the amount of \$1,609,970,000. In 1918 this figure had increased to \$2,506,814,000 and a study made in 1920 placed the amount at \$3,869,891,415.¹¹ On the basis of this estimate the farmers were then using approximately 18 per cent of the total bank credit of the country. An investigation made by the Joint Commission of

¹¹ V. N. Valgren, "Bank Loans to Farmers on Personal and Collateral Security," *U. S. Department of Agriculture Bulletin No. 1048*, 1922, p. 2.

Agricultural Inquiry corroborated these findings. It showed that during these six years all the loans and discounts of the banks of 13 of our principal agricultural states, excluding those of the largest cities, had increased from \$2,464,933,000 to \$5,348,078,000.¹²

In some of our principal agricultural states not only were the farmers willing to incur indebtedness recklessly, but all too often the bankers were encouraging them to borrow more money than they really needed in order to carry on their operations. Deposits were large and the bankers were anxious to loan them out. Many rural banks of the country were suffering from bad bank management, and the conservative influence which the banker usually exerts over his borrowers was absent during this period. Large numbers of small banks were started by men who knew nothing about banking. From 1914 to 1920, in the eleven states listed in the table on page 21, over 1,700 new banks were started. Two or three banks were frequently established in hamlets where one would have been more than sufficient. This led to keen bank competition with results disastrous to both farmers and bankers.

In the spring of 1920 special conditions combined to cause exceptionally large bank loans to agriculture. At the very eve of the agricultural depression, when farmers ought to have been strengthening their cash reserves and paying off some of their debts, they were forced deeper into debt by circumstances over which they had only partial control.

In the first place the heavy expense of putting in the spring crops necessitated a large amount of borrowing. The high price level was requiring the farmer to use

¹² 67 Cong., *Report of the Joint Commission of Agricultural Inquiry*, H. rep. 408, 1921, Pt. II (*Credit*), p. 94.

two or three dollars of credit to finance his operations where before the war one dollar had sufficed. Wages of farm labor were at their highest point. Five dollars a day was no unusual rate for a farmer to pay for his extra labor. Fertilizer had mounted to nearly three times its pre-war cost. Fencing had done likewise. In short, practically everything that the farmer had to buy in 1920 was at its very highest. The necessary expenses for raising corn, wheat, and cotton had increased over 100 per cent in five years. A situation of this kind could only result in increased borrowing at the banks.

The cattlemen were borrowing heavily at this time because of droughts which had caused them to suffer severely during 1918-19. The situation was particularly bad in Wyoming and Montana and in parts of the Southwest. The lack of rain had caused the death of thousands of cattle and the marketing of others before they were mature. Consequently the ranchmen had taken severe losses and had been unable to pay loans which they had previously contracted.

It was apparent in the spring of 1920 that the livestock industry was in no condition to do much liquidating of indebtedness. The credit standing of the ranchmen would not have been good even had there been an abundance of funds seeking investment, for the security they had was not of a high quality. There was a general feeling on the part of bankers of the cattle-raising districts, however, that something had to be done to help this industry.¹³

At the same time the transportation tie-up in the spring of 1920 kept the farmer from making his usual liquidation. This was particularly true in the case of the

¹³ See 67 Cong., *Minutes of Federal Reserve Board Conference, May 18, 1920*, S. doc. 310, p. 30.

cattle feeders in the Corn Belt states. It was no uncommon thing during April and May for a feeder to have his cattle ready for market and be unable to get cars to ship them. All too often he was not only forced to renew the notes he had given in order to purchase them, but to borrow additional amounts to purchase feed. While this was happening the price was going down.

This same condition prevailed with wheat and other commodities. Country elevators were filled with grain which they were unable to ship because of the car shortage. Mr. Becker, president of the Northwest National Bank of Minneapolis, estimated that in the Northwest there was about 200 million dollars in grain products tied up for lack of transportation in the spring of 1920.¹⁴ Kansas had almost two crops of wheat on her hands in May 1920. Some farmers no doubt were willing to hold the crop for higher prices, but the fact remains that they would have been unable to ship it out had they all desired to sell.

Finally, foreign demand for farm products had fallen off in 1920. This necessitated a large amount of credit to hold them here and prevented the usual spring liquidation. Particularly in the districts of Dallas and Atlanta was this condition evident. Mr. Scott, a director of the Dallas Federal Reserve Bank, estimated that in May there were a million bales of cotton being carried in Texas alone. Approximately one-half of this amount was standing ready to be sold, but the foreign buyer was not in the market to take it. Someone had to provide the funds to carry unsold crops, and this increased the burden upon the banks in those districts where commodities were being held.

¹⁴ The same, p. 43.

Psychology played no unimportant role in the credit situation of the farmer at the eve of the great price decline. The most extravagant talk about values was indulged in on all sides. Conservative farmers confidently expected land to go to \$500 per acre in the Corn Belt, and the real estate agents were talking \$1,000 per acre or more. The farmers were certain that the day of low prices for agricultural products was gone forever. Europe was disorganized, her population undernourished. Until normal conditions could be restored on the Continent the American farmer expected to furnish the food products for these nations. Thus it was generally believed that there would be a keen demand for farm products at high prices. Probably never in our history did the farmers set about their spring planting in a more hopeful mood than they did in the spring of 1920. In view of the European situation they reasoned that prices could not come down. Moreover they were at last organizing and had great hopes of what co-operative action would do in the way of maintaining prices.

But the farmers found, much to their surprise, that in spite of all these reasons, prices could fall—and that they could fall with startling rapidity. In August 1920 the Bureau of Labor Statistics general index number of wholesale prices stood at 231 per cent. Five months later, January 1, 1921, it had fallen to 170 per cent. The decline in farm prices was even more precipitous. In January 1921 the price level of farm products was 143 per cent of the 1913 level, and by June of the same year it had dropped to 114 per cent. The price levels for the corresponding dates of the previous years had been 247 per cent and 237 per cent respectively. The farmers were dumbfounded by this sudden price move-

ment. Not being particularly well informed about price changes in other countries, they did not associate this decline with world conditions but thought of it only as a domestic problem. In addition a good many farmers regarded it as a temporary condition which could be remedied if they would hold their products off the market for a little time.

When the farmers asked their bankers for loans to carry their products, however, they were refused. Moreover the bankers said that instead of asking for more credit the farmers should pay off some of their old loans. The situation was the same as obtains at the end of every business boom. Indebtedness was large, the demand for additional loans was heavy, and available bank credit was scarce. The banks of the country were borrowing heavily from the Federal Reserve Banks, and the resources of these institutions were being rapidly absorbed. An expansion in 1920 similar to the one of 1919 would have forced the reserve ratio of the Federal Reserve Banks below the minimum required by law. Obviously some control had to be exercised. The Federal Reserve Board, in its sixth annual report, summarized the situation in the following terms:

The expansion of credit set in motion by the war must be checked. Credit must be brought under effective control and its flow once more regulated and governed with careful regard to the economic welfare of the country and the needs of its producing industries.

Deflation, however, merely for the sake of deflation and a speedy return to "normal"—deflation merely for the sake of restoring security values and commodity prices to their pre-war levels without regard to other consequences, would be an insensate proceeding in the existing position of national and world affairs.

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Radical and drastic deflation is not, therefore, in contemplation, nor is a policy of further expansion. Either course would in the end lead only to disaster and must not be permitted to develop.¹⁵

This statement, together with many other utterances of the Board which were given from time to time, shows rather clearly that there was no intention to deflate the credit structure just for the sake of bringing the country down to a lower price level. Without any regard at all for price levels, or even for the security back of the loans, the reserve position of the Federal Reserve Banks required that the credit expansion which had been going on ever since the beginning of the war should stop.

However, restriction of loans by the Federal Reserve Banks to agriculture was not the cause of the rural credit stringency of 1920. There is no basis in fact for the assertion that the farmer's difficulty in securing credit during this time was due to the curtailment of Federal Reserve Bank credit to the country banks. Such curtailment did not take place. In spite of the increases in discount rates, Federal Reserve Bank credit continued to expand in the agricultural districts. For the country as a whole it did not reach its maximum until October 1920, and for the agricultural states not until midsummer of 1921.

The Joint Commission of Agricultural Inquiry found that between May 4, 1920 and April 28, 1921 the borrowings from the Federal Reserve Banks by member banks located in agricultural counties had increased 127.6 million dollars, or 56.6 per cent. During this same time the borrowings by banks in semi-agricultural

¹⁵ *Annual Report of the Federal Reserve Board*, 1919, pp. 71-72.

counties had remained practically stationary, and the borrowings by banks in non-agricultural counties had declined 629.1 million dollars, or 28.5 per cent.¹⁶ Out of a total liquidation of member bank loans amounting to 882 million dollars between these two dates, 94 per cent, or 827 millions, was by banks located in the non-agricultural counties. During this year on the whole there was practically no liquidation of Federal Reserve Bank credit in the agricultural districts.

The rapid decline of agricultural prices was the immediate cause of the credit stringency in the agricultural areas. While falling prices placed a severe strain on all banks, those in the agricultural sections suffered most because agriculture experienced a greater fall in prices than did the majority of the other industries. This disparity in prices, taken in connection with the slow turnover that agriculture normally has, made it much more difficult for the farmer and the farmer's bank than for the banks located in the industrial centers to adjust themselves to the rapid price deflation. While the decline in agricultural prices did not necessarily destroy the ultimate safety of the loan, it did fill the bankers' portfolios with "frozen assets." When we remember that wheat which sold in May 1920 for \$3.08 was only worth \$1.68 in December, that corn during the same period dropped from \$2.00 to \$0.76, and that cotton suffered an even worse decline, we can readily appreciate why the farmers could not pay their loans.

The rapid decline in prices reduced deposits in coun-

¹⁶ For this purpose the counties were classified as agricultural when the value of their products was estimated to be not less than 80 per cent agricultural; semi-agricultural when the value of their products was between 50 and 80 per cent agricultural; and non-agricultural when the value of their products was less than 50 per cent agricultural. See 67 Cong., H. rep. 408, Pt. II, pp. 101-02.

try banks and restricted their lending power. Unless help could be obtained from the outside this meant that the banks, instead of granting new loans, would have to contract old ones sharply. Otherwise they would experience an actual shortage in cash. The loss of deposits more than anything else makes it necessary for a bank to contract its loans. Pressure for the liquidation of loans because of declining deposits was greater in agricultural than in industrial sections. The Joint Commission of Agricultural Inquiry found that between May 4, 1920 and April 28, 1921 total bank deposits declined 11.1 per cent in the agricultural counties as compared with 5.2 per cent in the semi-agricultural counties and 4.4 per cent in the industrial counties.¹⁷

The figures for demand deposits alone are even more striking for this period. The reduction in these deposits in the agricultural counties was 20.02 per cent as compared with 13.14 per cent and 10.07 per cent in the semi-agricultural and industrial counties respectively. While loans and discounts were reduced by only \$36,548,648 in the agricultural counties, demand deposits showed a reduction of \$469,452,955. The percentage figures show that the agricultural counties suffered more from this reduction than the others.

The main cause for this loss of deposits by the country banks was that the farmers did not receive enough for their crops to liquidate the indebtedness they had incurred during the year and to meet current operating and living expenses. This meant that those farmers who had deposits in banks began to check them out in order to pay debts and to meet current expenses. Moreover the farmers did not receive enough from

¹⁷ The same, p. 115.

the sale of their products in 1920 to insure the agricultural sections a favorable balance of trade with the industrial centers. Consequently bank deposits were withdrawn from the country banks to make up this deficit. Thus there was a great decrease in bank deposits in our agricultural sections at the very time when there was such an insistent demand for more credit from those farmers who were unable to meet their obligations. The local banker was in an impossible situation. The more wealthy farmers of his community were withdrawing their deposits in order to pay their debts at the same time that the poorer farmers were asking him to extend their old loans and, in many cases, even to grant new ones.

The country bankers had either to contract their loans or to borrow very extensively from outside institutions. As a matter of fact both policies were pursued during the fall of 1920 and throughout 1921. Country banks borrowed extensively from the Federal Reserve Banks during this time, but nevertheless were in need of further credit accommodation. There were two fundamental causes for this. In the first place a large number of country banks were not members of the Federal Reserve system and had no way of reaching the Reserve Banks except through their city correspondents.¹⁸ In the second place, even before the price drop occurred, many country banks were borrowing excessively, and their position did not entitle them to further credit. The Joint Commission of Agricultural Inquiry found that in 1920 about one-third of the banks were greatly over-

¹⁸ Non-member bank paper could be rediscounted at the Reserve Banks if presented by a member bank, but many correspondent banks were over-extended and consequently were not anxious to assume more liabilities.

extended. To have extended credit freely to banks in such condition would have been to invite further expansion on their part and perhaps ultimate failure. It was only natural that both correspondent banks and Federal Reserve Banks should exert pressure for an over-extended bank to liquidate some of its indebtedness. Consequently a community that had to depend for its credit accommodation in 1920-21 upon such a bank inevitably felt the pressure for liquidation.

The country bankers would have been anxious to collect loans as rapidly as possible even had there been no pressure from the banking inspectors. As we have already noted, the margin of security on many of these loans had been so diminished that there was great uncertainty as to their payment. But in many cases for the farmer to pay them, even when he was able, worked considerable hardship. It must be remembered that when agricultural loans are made it is fully expected by both the farmer and the banker that a large majority of them will be renewed. The borrower intends to renew when he applies for a loan, and the banker extends him credit with this tacit understanding.

During normal times this arrangement works satisfactorily. In fact so accustomed are both farmers and bankers to renewals that in many rural communities no maturity date is put upon the note at all. The notes are demand notes, payable in theory at either the request of the banker or the wish of the farmer. In practice, however, they are payable when the farmer has the money to pay and not before. So long as the banker does not meet with any abnormal withdrawal of deposits he is able to continue these loans without difficulty. But if for some cause, such as a decline in prices or a

bad crop failure, the local banker finds that his deposits are being withdrawn just at the time when his customers are asking to have their loans renewed, he will be obliged to borrow extensively from outside sources or force a liquidation that will do a large amount of harm in his community. During the crisis of 1920-21 many country banks had difficulty in securing outside credit and consequently liquidation was their only alternative. Even farmers with good security frequently found it impossible to renew their notes, which gave plausibility to the widely accepted belief that a credit deflation was being forced for the purpose of bringing about lower prices.

The farmers made the mistake of confusing their price problem with their credit problem. What was taking place in 1920-21 was a world-wide price deflation that no conceivable credit extension in this country could possibly have stopped. This is not saying that the credit stringency of 1920 did not have any effect upon the trend of prices. Without a doubt the scarcity of credit accommodation led to hasty marketing in many cases where a more gradual process would have been desirable. It was natural that the farmers should think that the primary cause for the decline in price was the credit stringency. Just at the time when prices were falling and they did not wish to sell their products, the bankers asked them to pay up the loans they had incurred during the previous year. If the bankers would not ask them to pay but instead would grant them additional credit so that they could hold their products a little longer, the farmers believed that the prices would return to their previous level.

Moreover the farmers felt that if they had originally

been able to make their loans for periods of time more suitable to the nature of their industry, they would not have felt so severely the effects of the credit stringency. Consequently they set up a demand for a term of credit intermediate between that ordinarily granted by country banks and that granted by the Federal Land Banks. However, the need for immediate action was so imperative that attention was first centered on emergency relief. Congress revived and enlarged the activities of the War Finance Corporation to meet the critical situation while a study could be made of what was needed in the way of permanent rural credit legislation. The following chapter will be devoted to an analysis of the emergency credit relief extended by the War Finance Corporation and of the recognition which was given to the special needs of agriculture in drafting the Federal Reserve Act and in subsequently administering the Reserve system.

CHAPTER II

CREDIT AGENCIES SUPPLYING INTER-MEDIATE CREDIT PRIOR TO 1923

With the opening of 1921, credit conditions in many agricultural districts were verging on a panic. Although for the country as a whole the crisis had been safely passed, liquidation had not taken place to any considerable extent in the rural communities. While by mid-summer there was no scarcity of loanable funds in the industrial centers, there still remained a severe rural credit stringency. Prices were rapidly falling, country banks were losing their deposits, and farmers were being pressed to liquidate their indebtedness. The situation was graphically expressed by the managing director of the War Finance Corporation in the following words:

There was a state of demoralization everywhere among all classes of agricultural producers. Farmers and stockmen generally were in a desperate plight; breeding herds were being sacrificed on a wholesale scale; immature stock was being sent to the block; and cotton, corn, and other agricultural commodities commanded prices that were discouragingly low and in many cases materially below cost of production. Forced liquidation and hasty selling impaired the farmers' buying power and this in turn brought about a reduced demand for the products of the industry. Bank deposits were being withdrawn and reserves depleted, loans could not be collected, and the stability of our whole agricultural and banking structure was seriously impaired.¹

What was needed at this time to restore confidence was a source of loanable funds adequate to renew such agricultural paper as would eventually prove good if

¹ *Annual Report of the War Finance Corporation, 1922, p. 2.*

only additional time were given the farmers to liquidate it.² In June 1921 the Secretary of the Treasury, Mr. Mellon, suggested to a group of bankers that a pool of 50 million dollars be raised for the purpose of extending credit to the livestock industry. Some of the leading banks in New York City contributed 25 million dollars, and about 200 banks located in the cities of the North and West subscribed the rest. A corporation known as the Stock Growers' Finance Corporation was organized to administer the fund. This corporation made its first loan on July 20, 1921, and during the 87 days that it was in operation loaned over 20 million dollars, so keen was the demand for funds. It discontinued making loans on November 1, 1921, because by that time Congress had made provision for the War Finance Corporation to do this work.³

During this time Congress had not been unmindful of the plight of the farmer. The newly organized agricultural bloc was insisting that the need for additional credit facilities was so imperative that the government should intervene. There was a strong feeling in Congress

²The situation became so acute during the summer of 1921 that various state banking associations and some bankers in large cities began to concern themselves with what could be done to extend relief to the hard-pressed rural communities. In Iowa the State Bankers' Association, in co-operation with the Iowa Farm Bureau Federation, began the organization of a state-wide credit corporation with capital of 1 million dollars. However, this corporation did not get organized in time to be of any real service during 1921. In Wisconsin H. A. Moehlenpah, a former member of the Federal Reserve Board, organized a credit institution known as the Bankers' Finance Corporation to aid the rural bankers of that state to get in touch with additional sources of capital. In New York State the Farmers' Fund, Incorporated, a credit organization started during the war to extend credit to agriculture, experienced a demand for loans far in excess of its ability to grant.

³M. L. McClure, chairman of the board of directors of the Federal Reserve Bank of Kansas City, who was president of this corporation, states that practically all of these loans were repaid.

that, if something could be done to revive the foreign demand for agricultural products, the situation would soon turn for the better. Consequently a demand was made for the revival of the War Finance Corporation primarily to aid in financing the exportation of farm products.

I. REVIVAL OF THE WAR FINANCE CORPORATION

The War Finance Corporation had originally been established on April 5, 1918 in order to aid certain industries essential to the prosecution of the war in securing credit. At the close of the war, when it was feared that our foreign trade might fall off rather seriously if some extra credit was not extended to foreign buyers, Congress on March 3, 1919 authorized the War Finance Corporation to make loans to assist in the exportation of our products. Loans were to be made direct to American exporters or to banks who had loaned to the exporters. By the spring of 1920 Secretary Houston felt that, in view of the inflated credit condition of the country, together with the flourishing state of our export trade, the time had arrived to discontinue this work by a war agency. Consequently in May 1920, in keeping with the general policy of our government at that time that no more government credit be extended to foreign purchasers to buy our products, the activities of the War Finance Corporation were stopped.

But by the close of 1920 agricultural prices were so low that Congress was once more willing to stimulate foreign buying, if possible, even if the government had to furnish the funds with which to make the payments. Late in January 1921 the following joint resolution was passed by both houses:

That the Secretary of the Treasury and the members of the War Finance Corporation are hereby directed to revive the activities of the War Finance Corporation, and that said Corporation be at once rehabilitated with the view of assisting in the financing of the exportation of agricultural and other products to foreign countries.

The directors of the War Finance Corporation immediately began to concentrate their attention on how to stimulate the exports of the principal agricultural commodities by extending export credits. Cotton being one of our principal agricultural exports, attention was first directed to it. The Corporation offered to make loans to exporters to finance the carrying of cotton either when stored in foreign warehouses or when stored in this country. Early in July the Corporation agreed to advance 5 million dollars to the Staple Cotton Co-operative Association to enable it to finance the holding of 100,000 bales of cotton until they could be exported in an orderly manner. Later in the year the Corporation made advances to other co-operative marketing associations located in Texas, Oklahoma, and Arizona, as well as to a large number of banks in the South, for the same purpose.

The Corporation did not limit its advances to cotton, but during the year authorized loans to co-operative associations and banks to aid in exporting wheat, tobacco, condensed milk, dried fruits, and meat products. A small amount of funds was also loaned to aid in exporting manufactured products. The following table shows how these loans were distributed during the period from January 4, 1921 to November 3, 1923.⁴

⁴ *Annual Report of the War Finance Corporation, 1923, p. 16.* No loans were made for the financing of exports after Nov. 3, 1923.

Commodity	Loans Approved	Advances Made
Cotton	\$40,758,508	\$26,561,441
Grain	5,777,810	3,277,810
Tobacco	3,246,369	2,417,660
Canned fruits	1,120,000	325,060
Meat products	1,000,000	1,000,000
Condensed milk	1,000,000	1,000,000
Manufactures	5,471,566	4,071,566
Total	\$58,374,253	\$38,653,537

Of the total amount which was advanced to assist in the exporting of our products, 7.5 million dollars was loaned direct to exporters; 2.6 millions to co-operative marketing associations; and 28.5 millions to banking and financing institutions. The fact that only 66 per cent of the total amount which the War Finance Corporation agreed to loan for the purpose of financing exports was ever called for indicates that there was not such a great demand for funds to finance exports as was thought at the time.

The Corporation subsequently made loans for general agricultural relief. During the summer of 1921 it became increasingly clear that the mere extension of credit for the purpose of stimulating the export of agricultural products was not sufficient to meet the emergency. Additional rural credit relief was needed to meet the unusual credit conditions existing in the hard-pressed country districts. The country banks were losing their deposits and at the same time finding it difficult to collect their loans. A considerable part of these loans were good, but the farmers were in no position to pay them immediately. Under such conditions there was nothing the banks could do but renew the farmers' notes.

Although the Federal Reserve Banks were discounting large amounts for the country member banks, there

was still an insistent demand for additional funds. This was especially true for those banks which were not members of the Federal Reserve system and so had no direct connection with the discount facilities of the Reserve Banks.⁵ Many of these institutions were loaned up to their limit and were borrowing all they could from their city correspondents. As many of these city banks had all they could do to take care of their individual customers, it was natural that they should desire their country correspondents to pay up at least part of their borrowings.

Nowhere was the need for emergency credit relief more imperative than in the range cattle and sheep industries. We have already noted that the livestock industry was in a very critical condition at this time. Unwise attempts to stimulate production during the war by pursuing a policy of free and easy extension of credit had seriously inflated the industry. When the sudden drop in prices occurred in 1920 many of the banks and cattle loan companies were severely pressed for funds. Consequently they began to call in a considerable part of their loans. The result was particularly disastrous to the cattle industry. The unfortunate part of it was that in many cases the good loans of reliable ranchmen were called, because an effort to collect the poorer ones would have resulted in total loss.⁶ The failure of some cattle

⁵ The Federal Reserve Board, however, in the desire to help these institutions, permitted member banks to rediscount the paper of non-member banks with the Reserve Banks.

⁶ "We do not want any more free-for-all financing that we had before the war and during the war. The result was very disastrous—it nearly broke us. At the time of the crash, paper that was good was called and the paper that was bad was not called—the good men 'paid the freight right down the line.'" Fred H. Bixby, president of the American National Livestock Association, 67 Cong., *Rural Credits*, Hearings on S. 4063 (H.R. 13033) before House Committee on Banking and Currency, Nov. 24, 1922, p. 1.

loan companies tended to make city banks which had been accustomed to handling cattle paper very reluctant to take any more of it. It was apparent before the autumn of 1921 that additional financial machinery had to be set up to take care of the credit needs of the range industry or the losses to the sheepmen and cattlemen would be particularly severe.

Throughout the summer Congress had been debating the need of establishing additional rural credit facilities. No one knew, however, just what was required in the way of permanent legislation. Congress appointed the Joint Commission of Agricultural Inquiry to make a study of the causes of the agricultural depression and specifically directed it to report "upon the banking and financial resources and credits of the country, especially as affecting agricultural credits." However, in order to provide credit relief until this Commission could make its report and until permanent legislation could be enacted, on August 24, 1921 Congress passed an emergency agricultural credits measure by amending the War Finance Corporation Act. This amendment empowered the Corporation to make advances to "any bank, banker, or trust company in the United States, or to any co-operative association of producers in the United States which may have made advances for agricultural purposes, including the breeding, raising, fattening, and marketing of livestock, or may have discounted or rediscounted notes, drafts, bills of exchange, or other negotiable instruments issued for such purposes." The loans were to be made for a period not exceeding one year, with a privilege of renewing them

¹ 67 Cong., Public No. 60, Sec. 24. Originally this authority was to expire July 1, 1922, but it was extended several times, and not until Dec. 31, 1924 did the power to make new loans lapse.

up to three years. The total amount of loans that the Corporation could make at any one time was limited to 1 billion dollars.

Steps were immediately taken to set up the machinery necessary for making these loans. It was clear from the very first that the Corporation could not handle all the details of the business from its office in Washington. If the plan was to be a success the co-operation of the bankers of the country had to be secured, and local agencies for passing on the loans had to be established. By and large, an excellent spirit of co-operation was evidenced on all sides by bankers, business men, and farmers. The agricultural press, the leaders of the various farm organizations, and the co-operative marketing associations all worked together to formulate plans whereby the funds of the Corporation could be placed as quickly as possible where they were needed the most. Within a short time 33 agricultural loan agencies were established and were receiving and passing upon applications for loans.

These loans were not made direct to farmers. This was not feasible from an administrative point of view. In fact it would not have been desirable even if it had been possible from the practical point of view. What was needed at this time was not new loans indiscriminately made to farmers, but enough credit relief given to their local credit agencies so that these institutions would not need to press the farmers for liquidation. In keeping with this idea the Corporation was only empowered to make loans to financing institutions or to co-operative associations of producers of agricultural products. The farmer had to make his application for a loan as usual to his local bank. If the bank could not accommodate

him it could secure the necessary funds for making the loan from the War Finance Corporation by putting up the farmer's note as security. If the credit statement of the farmer was good, and if the local agricultural loan agency approved the loan, it was usually only a matter of a few days until the money would be sent to the bank. While every loan had to pass a final inspection at Washington, the approval of the local agency was usually relied upon.

Any bank or trust company that had agricultural paper in its portfolio could draw upon the resources of the War Finance Corporation, but the amount of funds that any one institution could get from the Corporation was limited by the amount of agricultural paper it had. However, the actual security for the loan did not have to be agricultural paper. It could consist of notes, bonds, warehouse receipts, bills of lading, or other guarantees and indorsements. A bank did not have to make any new loans to get an advance from the Corporation. Neither did it have to take the funds thus secured and loan them to farmers. If it were low in cash it could keep this money in its own vaults as reserve; if it desired it could pay off its indebtedness with its correspondent bank; or if it was a member bank it could use it to build up its deposit account with its Federal Reserve Bank.

Widest possible latitude was given the country bank in this respect. In the final analysis this institution was the best judge as to what should be done with the funds. If the pressure for liquidation were removed from the local banks, then these institutions could stop pressing the farmers for payment. In this way the farmer was aided by the Corporation although he may not have

received any of its money directly. Banks discounting paper with the Corporation were not permitted to charge their customers more than 2 per cent in excess of the rate charged by the Corporation.

Every loan was carefully safeguarded. If a goodly margin of good security could not be put up, the application was rejected. As we have previously noted, the local agricultural loan agency passed upon each application as it came in. If it approved the loan the application was sent on to Washington, where it was again carefully scrutinized by a board of examiners before it was accepted.⁸

While the amount of credit extended was small, it was by no means of negligible importance. At no time did the Corporation have outstanding more than 201 million dollars.⁹ When this figure is compared with the amounts that the Federal Reserve Banks had loaned in the agricultural states it seems very small indeed. In Iowa alone the Chicago Reserve Bank had nearly 100 million dollars at one time (December 1920). Figures for the other agricultural states show correspondingly large amounts. It must never be overlooked that all during this time the really large sums of money that were

⁸In many cases the country bankers complained that the Corporation required too much security. At a banker-farmer meeting, held in Des Moines, Iowa in November 1921, a large group of country bankers were of the opinion that the Corporation would be of no help to them because its requirements as to security were too strict. This of course was a one-sided view, but it does show that the Corporation exercised due care in placing its loans.

⁹This maximum was reached in May 1922. The total advances for agricultural and livestock purposes under the Act of Aug. 24, 1921 amounted to \$296,987,962, of which all but \$43,255 had been liquidated by Dec. 31, 1931. Of the total advances, 58 per cent went to banking and financing institutions, 29 per cent to livestock loan companies, and 13 per cent to co-operative marketing associations. *Annual Report of the War Finance Corporation*, 1929, p. 10; 1931, p. 3.

being used in the agricultural districts were being furnished by the Federal Reserve Banks.

In a crisis, however, the importance of a sum of money is greater than its amount would indicate. This was strikingly the case with the funds furnished by the War Finance Corporation. In the first place the funds went mainly into those states which were suffering the worst from the results of low prices. Then, what is of even more importance, they went to aid those banks which were suffering most severely from "frozen assets" and were finding it increasingly difficult to borrow from their accustomed sources. In other words, the War Finance Corporation really set up an emergency banking system for the benefit of the agricultural sections of the country. In those communities where bank credit had become frozen and where the bank resources were insufficient to take care of the legitimate demands of the farmers for credit, the funds of the Corporation were available for relief.

The Corporation's advances to banks were used chiefly for liquidating their indebtedness. An examination of the uses to which the funds of the Corporation were put in Iowa revealed the fact that well over 60 per cent of them were used by the country banks to pay off their indebtedness either at the Federal Reserve Banks or at their city correspondents. The greater part of the rest was used to renew the past due notes of the farmers. Only a very small portion of the total went to the farmers in the shape of new credit. Probably what was true for Iowa was also true for the other agricultural states. Country banks used the funds of the War Finance Corporation to tide them over a period when they were over-extended and on the verge of being compelled to close their doors because of insufficient liquid assets.

Later, when credit conditions became easier, the country banks borrowed from the Federal Reserve Banks or from their city correspondent banks to pay off the War Finance Corporation. They did this because there was less red tape involved in obtaining loans through the regular banking channels than from the War Finance Corporation.

There was much feeling at the time on the part of some of the farmers that the War Finance Corporation's main function was to get the country banker out of his trouble, and that it only incidentally helped the farmer out of his credit difficulty. This point of view is obviously unfair, for to the extent that the country banker was relieved from his credit difficulties he could ease the pressure for liquidation on his customers. In any event there was no effective way that the funds of the Corporation could be placed at the disposal of the farmers except through their local banks.

Cattle loan companies used the funds of the War Finance Corporation in much the same way as did the country banks. They made a limited amount of new loans to cattlemen, but the greater portion of the funds secured by these companies was used to renew loans that had previously been extended. The management of the Corporation was instrumental in reorganizing some cattle loan companies and in securing the capital for starting others. In this way it brought in a considerable amount of funds to finance this industry in addition to those that it loaned from its own resources. The status of the range cattle industry was so bad at this time that it was absolutely necessary to furnish some relief in order to keep the losses to the cattlemen as small as possible.

The financing of co-operative marketing associations was a special feature of the work of the War Finance

Corporation. During 1921 and 1922, when these associations were having extreme difficulty in securing the financial accommodation necessary to carry on their operations, the Corporation rendered them invaluable aid. Although the co-operatives had secured some funds from the banks located in the large financial centers on the security of warehouse receipts on non-perishable marketable agricultural products, they had not succeeded in securing a large amount of money in this way. In general they had to depend upon the banks situated in the vicinity where they were located. Inasmuch as the banking resources of these particular localities were insufficient in many cases to care for the demands of the co-operative associations, these organizations had to make connections with outside sources of capital if they were to be adequately financed. The War Finance Corporation was of great service to them in this respect.¹⁰

The end in view in extending credit to the co-operatives was to encourage the orderly marketing of agricultural products, not their speculative withholding in order to create an artificial scarcity for the sake of higher prices. Where there was any doubt of the policy of the association in question, the Corporation insisted that a part of the product held in storage should be marketed from time to time and the funds derived therefrom be used in part to liquidate the association's indebtedness.¹¹ As the co-operative associations carried out their part of the agreement faithfully, however, this was in no case necessary.

As a result of the work of the War Finance Corporation the co-operative marketing associations were able

¹⁰ "The most valuable financial ally which the co-operatives had in 1921 and 1922 was the War Finance Corporation." Herman Steen, *Co-operative Marketing*, p. 342.

¹¹ *War Finance Corporation Circular No. 3, 1921.*

to secure funds from the banks more easily. The restoration of confidence that resulted from the advances of the Corporation was even more important than the amounts of money furnished by it.¹² When the local banks saw that the Corporation stood ready to lend these associations large sums of money, they too in a good many cases found funds to loan them.

The experience of the War Finance Corporation also showed that safe methods of financing the orderly marketing of agricultural products through co-operative associations could be devised. Commodity financing on the basis of goods stored in warehouses had been done quite successfully previous to this by the fruit associations in California. But the New York banks had never accepted very cordially the idea of making large loans to co-operative associations on the basis of commodities stored in warehouses. The War Finance Corporation demonstrated that this could safely be done.

The primary service that the War Finance Corporation rendered the farmers' local credit institutions was to furnish them a place where they could exchange their "frozen credits" for liquid assets. In many ways this service resembled a moratorium. By holding agricultural paper during this period of credit stringency the War Finance Corporation gave the farmers and their country banks time to secure funds to liquidate their indebtedness. In its work with the co-operative marketing associations it did more than this. It guaranteed them credit at a time when these newly created marketing agencies were finding it difficult to secure funds.

The War Finance Corporation was not an institution

¹² In the marketing season of 1921-22 it had approved loans to the amount of 64.3 million dollars, but it was only called upon to advance 19.2 millions. *Annual Report of the War Finance Corporation, 1922, p. 7.*

established to meet the usual needs of agriculture for intermediate credit. It was an emergency organization, created to cope with the particular problem of "frozen credits" that had its origin in the great price decline in agricultural products following the war and in the resultant slow movement of these products to the market. Serviceable as the Corporation was in the emergency of 1921, it was not adapted to serve as a permanent part of our rural credit structure.

II. THE FEDERAL RESERVE BANKS AND INTERMEDIATE CREDIT

The deliberations preceding the Federal Reserve Act had in mind the revising of the whole banking structure in the interests of all classes of business. During the debates and hearings that were held in Congress the agricultural interests were actively engaged in seeing that the bill as drafted should include special provisions for the farmer's benefit. Inasmuch as several of the purposes that the agricultural leaders had in mind had direct reference to those phases of the rural credit problem that have since come to be known as intermediate credit, we must note particularly the special agricultural credit provisions that were placed in the Federal Reserve Act, and how adequately these provisions worked out in practice to meet the intermediate credit needs of the farmers.

One of the two specific provisions in the Federal Reserve Act relating to agricultural credit deals primarily with mortgage credit and would seem to have no relation to the intermediate credit problem. Inasmuch, however, as no inconsiderable part of the proceeds of farmer loans made on land mortgage security goes for intermediate credit uses, anything that gives the farmers'

local credit institutions greater freedom in making loans on mortgage security increases the ease with which farmers can get funds. The National Bank Act had prohibited national banks from making loans to farmers on real estate mortgage security. This restriction had limited the service that national banks could render the farmers and had hampered them in their competition with state banks.

The Federal Reserve Act gives national banks permission to extend credit on real estate mortgage security. After a long debate as to the extent that a national bank should be permitted to loan on the security of farm lands the following provision was incorporated in the Federal Reserve Act as it was finally passed:

Any national banking association not situated in a central Reserve city may make loans secured by improved and unencumbered farm land situated within its Federal Reserve district, but no such loan shall be made for a longer time than five years, nor for an amount exceeding fifty per centum of the actual value of the property offered as security. Any such bank may make such loans in an aggregate sum equal to twenty-five per centum of its capital and surplus or to one-third of its time deposits.

This provision was important to the farmers not only because it gave them another source of funds for long-term credit but also because it increased the eligible security which they had to offer for their production loans. From a national bank's point of view it increased the safety with which it could make loans to farmers. National banks, previous to the passing of this provision, had been forced to make their loans on the security of the farmer's personal note. Now, when necessary, they could reinforce this security by taking a mortgage on his land. The McFadden-Pepper Act of 1927 further

liberalized the Federal Reserve Act in regard to real estate loans. It permits national banks to loan upon any form of improved real estate located within 100 miles of the loaning bank in an amount equal to one-fourth of its capital and surplus but not in excess of one-half of its savings deposits.

The section of the Federal Reserve Act of most importance to farmers, however, governs the eligibility of agricultural paper for discount. Prior to the passage of the Federal Reserve Act country banks rediscounted very little paper. While it is true that some country banks procured funds for seasonal requirements from their city correspondents on the strength of the country banker's own personal note, and sometimes through the sale of securities, still there was no customary practice of rediscounting their customers' paper with the larger banks in order to get funds to loan out in the country communities.¹³

When the provisions covering the admission of state banks to membership in the Federal Reserve system were under discussion, it was pointed out time and again that country banks would get no benefit from joining the system if all discounts were limited to 90 days. It was generally recognized that loans in the South and West ran for a longer time than did loans in the East. Banks located in these districts were the farmers' banks, and if membership in the Federal Reserve system was to be made attractive to them their paper had to be made eligible for discount for periods of time suited to the industry they served. The contention that agricultural paper had to have a longer term of maturity than the pa-

¹³ See O. C. Lockhart, "The Development of Interbank Borrowing in the National System," *Journal of Political Economy*, 1921, Vol. XXIX, pp. 222-40.

per of other businesses, together with the fact that country bank membership in the system would not be attractive if the farmers' paper was denied the privilege of discount at the Reserve Banks, led to the special time provision of six months being granted to agricultural and livestock paper.¹⁴ Section 13 of the Act, which contains the terms governing the discounting of paper for member banks, while it limits the maximum period of discount of commercial paper to three months, makes the following special provision for agricultural paper:

That notes, drafts, and bills drawn or issued for agricultural purposes or based on livestock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the capital of the Federal Reserve Bank, to be ascertained and fixed by the Federal Reserve Board.¹⁵

Inasmuch as the success or failure of any law depends quite as much on the way the law is administered as it does upon the content of the measure, it is necessary for us to examine the rulings and decisions of the Federal Reserve Board in matters pertaining to agricultural credit if we would find out to what extent the facilities

¹⁴ 63 Cong. 1 sess., *Banking and Currency*, Hearings on H. R. 7837 (S. doc. 232) before Senate Committee on Banking and Currency, Pt. II, p. 2462.

¹⁵ The agricultural interests also tried to have the Secretary of Agriculture made an ex officio member of the Federal Reserve Board as one who "was sympathetic with and understood the credit needs of agriculture." This effort failed, although the Secretary was placed upon the committee that organized and established the Federal Reserve Banks. During the crisis of 1920-21 the demand for an agricultural representative was renewed, and Congress responded on June 3, 1922 with an amendment to the Federal Reserve Act providing for an additional member on the Board who, it was tacitly understood, should represent the agricultural interests. After being occupied for nine years by a "dirt farmer," this post went, in the fall of 1931, to a country banker from Nebraska.

of the Federal Reserve Banks were actually placed at the farmer's disposal. One must keep it in mind that the Federal Reserve Banks have no power to make direct loans to any individual. Their primary function is either to discount paper for member banks or to buy certain types of paper in the open market. Thus if we wish to know what service these institutions may render to agriculture, we must consider what classes of paper they can discount for the country banks and what types of agricultural paper they can buy in the open market.¹⁸

Country bank paper consists primarily of farmers' notes given to secure funds to make improvements upon the farm, to purchase equipment, machinery, and livestock, or to meet expenses while crops are being produced and marketed. By far the greatest part of this paper is not, strictly speaking, short-time self-liquidating paper. Certainly it can hardly be classified as commercial paper. On the average it will have a normal maturity of more than a year. Under the threefold classification of credit as short-term, intermediate, or long-term, the greater part of it would have to be classified as intermediate. The Federal Reserve Board had to decide what portion of this paper was eligible for discount under the terms of the Act.

The Federal Reserve Board interpreted the phrase "notes, drafts, and bills of exchange drawn or issued for agricultural purposes or based upon livestock" in a liberal manner. Soon after the system was established the Board had to decide what "drawn or issued for an agricultural purpose" included. In an informal ruling it held

¹⁸ Of course to the extent that our banking system was improved by the Federal Reserve Act, farmers, like other classes, were benefited thereby. We are merely pointing out here some of the direct points of contact between the Reserve Banks and agriculture.

that it was not necessary for a member bank to make any close inquiry into what a farmer did with the proceeds of a loan so long as it was reasonably certain that the primary purpose of the loan was to aid agriculture. Frankly admitting that a portion of a farmer's borrowing goes to pay his living expenses while he is producing a crop, the Board ruled that although the proceeds were used for consumption purposes the eligibility of the loan was not destroyed.¹⁷

In regard to paper "based upon livestock" no narrow classification based on the liquidity of the loan was given. This in spite of the fact that it is generally recognized that the only livestock loans that are self-liquidating in short periods of time are those the proceeds of which are used either for fattening or for marketing the animals. The question arose as to whether notes given to purchase dairy cattle, horses, or other animals which were to be used on the farm over a long period of time should be eligible for discount. That the Board admitted this class of paper to the discount privilege goes to show that it was desirous of placing the facilities of the Federal Reserve Banks where they could be freely drawn upon for the farmer's benefit for purposes which partake of the nature of intermediate credit.¹⁸

The Federal Reserve Board also ruled that farmers' notes given to purchase implements were eligible for discount. A good deal of farm machinery is of a rather permanent nature, that is, it lasts for a period of years. Certainly the expense of purchasing a tractor or a reaper cannot logically be assessed against any one year's operation. Farm machinery, while it is not of such a fixed character as farm buildings or drainage projects, par-

¹⁷ *Federal Reserve Bulletin*, 1915, Vol. I, p. 72.

¹⁸ The same, 1916, Vol. II, p. 112.

takes somewhat of the same nature. However, if farm implements were to be classified as fixed investments the same as buildings, the farmers' notes for this purpose would not be eligible for discount. Although, as the Board pointed out, "the question is a very close one," it decided to admit such paper to the Reserve Banks.¹⁹

When the question came up as to the marks of identification a note had to bear in order to be classified as agricultural, the Board decided that a simple memorandum attached to the note, stating that it was drawn in payment for agricultural purchases, signed either by the maker or the acceptor of the note, would probably be considered sufficient evidence as to its agricultural character. As a matter of practice it is left to the member bank to decide what paper is agricultural. The management of the Federal Reserve Banks does not attempt to question the statement of the member bank in this regard.

In accordance with Section 13 of the Act the Board

¹⁹ The same, 1916, Vol. II, p. 67. Early in the history of the Federal Reserve system, in connection with implement paper, the question arose whether it made any difference regarding classification who presented the farmer's paper. For instance, if a farmer gave his note to a merchant in purchase of some articles needed to run his farm, could the merchant discount this note and still have it admissible to the agricultural class? The Board decided that this paper was to be classed as agricultural, no matter who presented it. It gave as its reason for the decision the fact that in this manner greater credit facilities would be given the farmer.

This ruling of the Federal Reserve Board was more liberal than a later ruling of the Federal Farm Loan Board covering the same point. The Farm Loan Board ruled that notes given by farmers to merchants for the purchase of farm supplies, machinery, fertilizer, etc., could not be discounted by the Intermediate Credit Banks. It based its ruling upon the grounds that the proceeds of such notes have not been "advanced or used in the first instance for any agricultural purpose"; that the service was to a merchant, not to a farmer; and that the purpose was commercial rather than agricultural. See *Federal Farm Loan Board Circular No. 15*, 1925, p. 14.

had to decide the amount of agricultural paper drawn for six months that a Federal Reserve Bank could discount. The Board decided to permit the Reserve Banks to discount the maximum amount allowed by the law, and fixed the limit at 99 per cent of a Reserve Bank's capital. It also held that the term "capital" referred to the subscribed capital of a Federal Reserve Bank. Thus, if necessary, the 99 per cent limitation might permit the Federal Reserve Bank to discount six-month agricultural paper to the extent of 198 per cent of its paid-in capital.²⁰ Later, when this provision of the Act was amended so that the amount of agricultural paper having a maturity of six months was to be limited to a certain per cent of a Federal Reserve Bank's assets, the Board decided that its 99 per cent ruling should apply to this new provision of the law.²¹ Thus it can be seen that for all practical purposes there was no limitation placed on the amount of six-month agricultural paper that could be discounted by the Reserve Banks.

But loans to aid in production are not the only need that the farmer has for credit for a longer period than three months. Of equal importance now is such credit accommodation for crop-moving purposes. During 1920-21, when the agitation for the establishment of special intermediate credit institutions first began, it was asserted that the Federal Reserve Banks had been so administered that funds had not been available to per-

²⁰ *Federal Reserve Bulletin*, 1916, Vol. II, p. 443.

²¹ When the maturity of agricultural paper eligible for discount at the Reserve Banks was extended to nine months by the Agricultural Credits Act of 1923, the Board limited the total amount of such paper that the Reserve Banks could discount to 10 per cent of a Reserve Bank's assets. Inasmuch as the Agricultural Credits Act established the Intermediate Credit Banks to handle this longer term paper, there was no need for a more liberal ruling on this point.

mit the farmers and their associations to pursue a program of orderly marketing.

A careful examination of the Board's decisions on all questions relating to the marketing of agricultural products clearly reveals an attitude favorable to the orderly marketing of farm products. In the fall of 1915, when it was feared that there might be some difficulty in the movement of crops, particularly cotton, Governor Charles S. Hamlin of the Board, in a letter to all the Reserve Banks in which he pointed out the advantages of orderly marketing, said:

In order to accomplish this end, it is suggested that Federal Reserve Banks adopt a definite policy with reference to rediscounting paper secured by documents in satisfactory form evidencing the ownership of stored agricultural products. Through such a policy, together with proper methods of warehousing, Federal Reserve Banks can be a potent factor in assisting the normal movement of staple agricultural products from the field to the factory or to the consumer.²²

The Board went so far in its desire to see that adequate credit was established for the marketing of agricultural products that on September 3, 1915 it established a special commodity rate of 3 per cent on notes secured by non-perishable, readily marketable staples properly stored in warehouses. Furthermore member banks were prohibited from charging their customers more than 6 per cent. This is the only instance in the history of the Federal Reserve system where the Board limited the rate that member banks could charge customers.

Obviously the making of loans to aid the farmer to pursue a policy of orderly marketing should not be confused with loaning for the speculative withholding of

²² *Federal Reserve Bulletin*, 1915, Vol. I, p. 258.

farm products for higher prices. The Federal Reserve Banks are not supposed to discount paper the proceeds of which have been or are to be used for the speculative withholding of farm products from the market. There is, to be sure, a twilight zone between the two phrases "orderly marketing" and "speculative withholding" that has never been defined. The Board has never issued any rule covering this point, its attitude being that the Federal Reserve Banks in their dealings with the member banks are in a better position to judge of this question than is the Board. Inasmuch as loans of this nature are very hazardous it is not to be expected that local banks will make any large amount of them. In this fact probably lies the principal safeguard against speculative loans getting into the Federal Reserve Banks in any large amounts.

The facilities of the Federal Reserve Banks were put effectively at the service of the co-operative marketing associations. The Board showed a sympathetic understanding of the needs and purposes of these new marketing agencies and manifested a desire to work with them in developing suitable methods of financing their business. Taking as a basic principle that the carrying of a crop, pending its orderly marketing, was an agricultural operation, the Board decided that money borrowed by a grower of farm products to enable him to meet his obligations without immediately selling his crop after harvest was an agricultural loan. Consequently if a member of a co-operative association delivered his product to the association and then drew a draft against the association, this draft would be classified as agricultural paper. The farmer could discount the draft at his local bank; and if the local bank was a member of the Federal Reserve system it could rediscount it with its Re-

serve Bank.²³ In this manner the resources of the Federal Reserve Banks could be drawn upon to aid in the financing of the co-operative marketing movement.

These drafts were also classified as bills of exchange drawn against actual existing values.²⁴ This classification is very important, because it excludes such drafts from the 10 per cent limitation on the aggregate amount of paper of any one borrower which a Federal Reserve Bank may discount for any one member bank. As a result a local member bank is permitted to rediscount as much as 25 per cent of the amount of its capital stock and surplus for any one borrower. This enables the local institution with limited capital to render a much more efficient credit service to the co-operative movement.

The rediscounting of paper of their farmer members was not sufficient credit accommodation for the co-operative marketing associations, as the latter had to borrow large sums of money on their own notes. These associations usually followed the practice of giving the farmers an advance payment of approximately 50 per cent of the value of their crops at the time they were delivered to the association. This necessitated that the associations borrow large sums of money; and when their notes were presented by the member banks for rediscount the question of eligibility arose.

The Board ruled that the notes of co-operative marketing associations, given for the purpose of obtaining funds with which to make payments to their members, were eligible for discount by the Reserve Banks. However, it classified this paper as commercial rather than agricultural, on the ground that co-operative associa-

²³ The same, 1921, Vol. VII, p. 1199.

²⁴ The same, 1922, Vol. VIII, p. 1286.

tions are business organizations. There was considerable difference of opinion at the time as to whether this paper should be eligible for discount at all. The question hinged upon whether the payments of the association to its members at the time the members delivered their products were to be considered as payments on account of the purchase price of crops bought by the association, or whether they were to be considered as an advance or loan by the association to its members. If the former were the case, obviously the paper would be entitled to the discount privilege and would be placed in the commercial class.

If the payments which the association made to its members were to be considered as advances or loans to them, this paper would be ineligible for discount, as it is specifically provided in the Federal Reserve Act that no paper is eligible for discount if the proceeds are to be used for what is known as "a finance purpose" or for re-lending to another person.²⁵ Although the Board admitted that the transactions between the members and the association were more in the nature of consignments than of sales, it nevertheless gave its opinion that the notes of the association, the proceeds of which were to be used to make advance payments to its members, should be eligible for discount.²⁶

The Board also ruled that drafts drawn by co-opera-

²⁵ This was changed by the Agricultural Credits Act of 1923 so that "factor's paper" with maturities up to 90 days can be discounted by the Reserve Banks.

²⁶ The Agricultural Credits Act of 1923 gave this paper the same privileges as agricultural paper. It is now eligible for discount at the Reserve Banks for periods of nine months (1) if the proceeds of the loan are advanced to members for an agricultural purpose, (2) if they are used to pay members for farm products delivered, or (3) if they are employed to finance the association in grading, packing, processing, or in marketing the products grown by its members.

tive marketing associations and secured by readily marketable agricultural staples when accepted by member banks were eligible for discount or purchase by the Reserve Banks. When the proceeds of the acceptances were used for agricultural purposes the paper could have a maximum maturity of six months, but if used for other purposes its maturity was limited to 90 days. It is difficult to over-emphasize the importance of an adequate discount market for acceptances to the proper financing of the co-operative marketing movement. Located in the interior of the country, as many of these associations are, where local bank resources are not sufficient for their needs, it is imperative that a way be opened whereby they can reach the funds in the larger money markets.

It was the lack of a ready access by borrowers in the interior to our central money markets that was one of the most outstanding defects of our banking system previous to the passage of the Federal Reserve Act. So far as co-operative marketing associations are concerned the Federal Reserve system has remedied this by making possible a discount market in which bankers' acceptances can freely be negotiated. These credit instruments afford the means by which marketing associations, although located many miles distant, can easily reach the New York money market. Thus where local banking resources are inadequate to meet the credit demands of a co-operative association, a way is now afforded whereby the association can make arrangements for credit extension with large city banks whose standing is such that an investing public will seek to purchase drafts accepted by them in whatever volume offered.

The resources of the Federal Reserve Banks were placed more directly at the disposal of the co-operative

marketing associations when the Board on December 19, 1922 issued a ruling permitting the Reserve Banks to purchase in the open market bankers' acceptances drawn by co-operative marketing associations with or without the indorsement of member banks.²⁷ These acceptances could have maturities up to six months. They had to be secured by warehouse receipts or similar documents conveying title to readily marketable staple agricultural products. We have already noted that bankers' acceptances, drawn by co-operative associations against warehouse receipts covering agricultural commodities, could be rediscounted for a member bank, but of course they had to be indorsed and presented by the member bank.

This new ruling placed the open market operations of the Reserve Banks at the disposal of the co-operative associations. In a very real sense it placed at their command the banking resources of the country. Today the Federal Reserve system provides the way whereby co-operative marketing associations can easily reach the money markets of the large cities. Large sums of money have been advanced to them by banks located in the money centers of the country at rates as low as those enjoyed by the large industrial and manufacturing concerns.

There are no accurate data to show the amount of Federal Reserve Bank credit that has been used in agriculture. It is true that the Reserve Banks classify their paper, according to the purpose for which the proceeds of the discounted notes are put, as commercial, industrial, or agricultural. But the figures given under the classification marked agricultural do not present an accurate picture of the amount of Federal Reserve credit used by agriculture. In the first place a large number of mem-

²⁷ *Federal Reserve Bulletin*, 1923, Vol. IX, p. 19.

ber banks rediscount agricultural paper only as a last resort. Owing to the fact that commercial paper usually runs for shorter periods, they tend to rediscount more of this class of paper. The proceeds, however, may be used to loan to agriculture rather than to other kinds of business.

Again, the banks in the larger cities frequently loan large sums of money to the small country banks. In turn the city banks frequently secure these funds from the Federal Reserve Banks. The paper which they rediscount, however, is practically always commercial paper, as that is the only kind they have. But the loans which they make to the small country banks are practically all used to finance agriculture, although the paper is classified on the books of the Federal Reserve Bank as commercial rather than agricultural. Thus it is impossible to tell from the records kept by the Federal Reserve Banks how much of the credit extended by these institutions ultimately goes to finance the requirements of agriculture.

In any event it was not felt by agricultural interests that the services of commercial banks, however liberal their policy, met fully the demand for intermediate credits. The demand for special legislation was therefore pressed continuously through 1921 and 1922 until it resulted in the passage of the Agricultural Credits Act of March 4, 1923. In the following chapter we shall examine the legislative history of this Act.

CHAPTER III

THE LEGISLATIVE HISTORY OF THE AGRICULTURAL CREDITS ACT OF 1923

On the last day of its last session the 67th Congress passed the Agricultural Credits Act of 1923. This Act established an agricultural banking system designed to become a permanent part of our credit structure. It was the result of a series of discussions, rural credit hearings, and congressional investigations lasting over three years. In its final form it was the amalgamation of several bills, each of which had been specifically designed to solve the farmers' credit problem. As it is impossible to understand many of the provisions of the Agricultural Credits Act apart from the political considerations that gave birth to the Act, this chapter will be devoted to a brief discussion of its legislative history.

The passage of the Federal Reserve Act and of the Federal Farm Loan Act had not stopped the demand for further rural credit legislation. In spite of the rapid growth of country banks from 1914 to 1920, the demand for the establishment of additional rural credit agencies kept coming up in Congress. The motive back of the continued rural credit agitation during this time was the desire to stimulate agricultural production. As late as February 1920 a rural credits bill was introduced into Congress and supported on this ground. It was contended during this time that frequently farmers were forced to work with poor equipment and to keep inferior livestock, just because they lacked adequate credit accommodation. However, there never was sufficient interest in the rural credit bills introduced into Congress

between 1916 and 1921 to get them reported out of the Committee on Banking and Currency and brought before Congress for a final vote.

The rural credit agitation of 1920-23 was not prompted by a desire to increase agricultural production. This time the argument for the enactment of additional credit legislation was based upon the necessity of having additional credit for the purpose of maintaining agricultural prices. We have already noted that the farmers thought the decline in the prices of their products was primarily due to a lack of credit accommodation. They firmly believed that the Federal Reserve system had deflated the country in the interest of "big business" and to their detriment. Consequently, they demanded representation on the Federal Reserve Board and the establishment of special credit institutions for their own particular use so that such a credit deflation might not occur again.¹

Congress first gave recognition to this renewed demand of the farmer for more credit when it made its annual appropriation for the Department of Agriculture for the fiscal year 1920-21. At this time it made pro-

¹ It was much to be regretted that many farmers had become accustomed to thinking of the Federal Reserve Banks as established primarily to serve city business men. They never fully understood the purpose of the establishment of these institutions or the theory on which they were operated. The principal reason for this was that by far the greatest number of country banks which served the farmers never became members of the Federal Reserve system. As a result neither the farmers nor the farmers' banks knew very much about the actual operations of the Federal Reserve Banks. To make conditions worse, a good deal of hostility toward these banks arose in the agricultural districts of the South and Southwest over the unfortunate controversy with the small state banks about the par clearance of checks. It was primarily due to a misunderstanding of the functions of the Federal Reserve Banks and a lack of knowledge of the services these banks were rendering that so great a part of the farmers came to think of the Federal Reserve system as being of no service to agriculture.

vision for the appointment of a joint committee on short-time rural credits. This committee was instructed to investigate and report as soon as possible on the practicability of establishing a short-time rural credits system in the United States and to recommend such legislation as might be desirable to that end. During 1921 the committee held hearings in various places in the country in the attempt to find out just what was the actual status of the short-term credit facilities of the farmers. In its report it recommended that the Federal Reserve Act be amended so that the Reserve Banks would be empowered to make advances to the country banks under the same terms and conditions as the War Finance Corporation.² This recommendation was never given serious consideration in Congress. Although the committee gathered a considerable amount of information on rural credits, none of the bills which were later passed can be traced to its work.

I. RECOMMENDATIONS OF THE JOINT COMMISSION OF AGRICULTURAL INQUIRY

When the 67th Congress met in its first extra session it immediately turned its attention to a consideration of the status of agriculture. On June 7, 1921 Congress provided for the Joint Commission of Agricultural Inquiry, consisting of five members, to investigate and report upon the following subjects:

1. The causes of the existing condition of agriculture.
2. The cause of the difference between the prices of agricultural products paid to the producer and the ultimate cost to the consumer.

² 67 Cong., *Report of the Committee on Short-time Rural Credits*, H. rep. 1174.

3. The comparative condition of industries other than agriculture.

4. The relation of agricultural prices to the prices of other products.

5. The banking and financial resources and credits of the country, especially as affecting agricultural credits.

6. The marketing and transportation facilities of the country.

This Commission held numerous hearings upon practically every phase of the agricultural situation, and late in 1921 issued a four-volume report. Volume II of this report deals exclusively with the agricultural credits problem. The Commission exonerated the Federal Reserve Banks from the charge of curtailing bank loans in the rural districts for the benefit of the cities, and from pursuing a policy of credit deflation in order to bring down the prices of agricultural products.³

The Commission reported, however, that the bank credit facilities of the farmers were not adequate. It was contended that inasmuch as the usual period of bank credit was six months or less, the farmers were unable to get credit accommodation to synchronize with their annual turnover. The farmer's credit needs were for loans with maturities which enabled him to make payments out of the proceeds of his farming operations. In the opinion of the Commission a term of credit running from six months to three years would meet these needs. The period would depend upon the kind of farming operations carried on, and upon the length of time over which the marketing process was distributed.

It was assumed that banks did not customarily make loans for periods of over six months because the Federal

³ 67 Cong., *Report of the Joint Commission of Agricultural Inquiry*, H. rep. 408, Pt. II (*Credit*), p. 117.

Reserve Banks could not discount paper with a longer maturity than this. At the same time, mortgage companies could not successfully handle loans of this nature, as the mortgage procedure is too cumbersome to be used for loans running only a year. Consequently, in the opinion of the Commission, there was a gap between the short- and long-term credit facilities furnished to the farmer which ought to be filled in some way.

The Commission proposed to meet this need by establishing Intermediate Credit Banks as adjuncts to the Federal Land Banks. It recommended that a separate department be created in each Federal Land Bank for the purpose of discounting for the country banks agricultural paper with maturities running from six months to three years. To furnish credit facilities for the farmers' marketing associations these new departments were to be permitted to make direct loans to co-operative marketing associations. The initial capital necessary to set up these departments was to be furnished by the United States Treasury. Such funds as were later needed were to be derived from the sale of debentures, issued on the security of agricultural paper discounted for the farmers' local credit agencies. In its report the Commission drew up a tentative rural credit bill including these provisions and recommending its passage to Congress.⁴ It was subsequently introduced into Congress and became known as the Lenroot-Anderson bill.

II. RURAL CREDIT DEFECTS BROUGHT OUT IN CONGRESSIONAL HEARINGS

The recommendations of the Joint Commission of Agricultural Inquiry were not deemed fully satisfactory, however, and the House and Senate Committees on

⁴ The same, pp. 9-11.

Banking and Currency held extensive rural credit hearings during the summer of 1922. Country bankers, farmers, and representatives of practically every farmers' organization in the country were called before these committees. Although there was considerable agreement as to the evils complained of, there was the widest difference of opinion as to what was needed in the way of credit legislation. Perhaps the most general complaint that was made to the committees was that the farmers could not get enough credit to enable them to hold their products off the market when they desired. Time and again, the statement was made that the farmers had to sell their cattle and crops of 1920 and 1921 before they desired to do so because the bankers refused to renew their notes when they became due.

The agricultural interests demanded a term of loan longer than six months. Inasmuch as the agricultural turnover was typically about twelve months, farmers insisted that financing their operations on loans running from three to six months placed them too much in the power of the bankers. If the latter did not wish to renew their notes when they came due, the farmers had no recourse but to sell their products in order to get the funds to pay their obligations. This, they insisted, frequently led to the sale of immature livestock and the premature marketing of crops.

High interest rates were complained of. Numerous instances were cited where farmers had to pay rates of 8, 10, and 12 per cent for the loans which they secured at their local banks. The farmers knew that these rates were much higher than those paid by city business men, and naturally they wondered why it was that they had to pay so much for their credit accommodation. Some

farmers felt that lower interest rates could be secured through the organization of co-operative banks. A bill providing for the organization of such banks was introduced by Senator Brookhart, but it was not reported out of committee.

While the movement for the organization of co-operative banks never gained a strong following in Congress, traces of its influence can be seen in the Agricultural Credits Act of 1923. Throughout the hearings an insistent demand was made that whatever additional rural credit facilities were established, these institutions must be empowered to lend to co-operative associations of farmer borrowers as well as to local banks.⁵ In this way the farmers, if the local banks did not grant them credit on what they considered reasonable terms, hoped to be able to secure loans elsewhere. The agricultural credit corporation, one of the most distinctive features of the Agricultural Credits Act as finally passed, was the result of this demand.

The farmers also complained a good deal about being unable to get credit accommodation at certain times on any terms. Every once in a while their local banks would be loaned up to their limit, and thus the farmers would be unable to get credit under any conditions. This, the farmers thought, was one of the principal causes for the great price decline in their products in 1920-21. We have already analyzed this question in a previous chapter and found that it was the price decline that was responsible for the credit contraction rather than vice versa. But so far as the farmers were concerned, it did not mat-

⁵ See statement of Gray Silver on behalf of the Farm Bureau Federation, 67 Cong. 3 sess., *Rural Credits*, Hearings on S. 4280 (H.R. 13033) before House Committee on Banking and Currency, Pt. II, pp. 254-56.

ter what was the cause of the credit stringency. They were determined to set up some kind of credit machinery to see that it did not happen again.

We may summarize the evils in the rural banking system that the farmers complained of as follows:

1. Loans were not made for periods of time suitable for agricultural production and marketing. Commercial bank loans were made for too short a period and mortgage loans for too long a period to meet the farmers' needs for working capital.

2. The cost of the farmer's credit was too high. He complained that he had to pay a higher interest charge than did merchants or manufacturers in the cities.

3. The farmer did not have a dependable source of credit. Forced to rely exclusively upon his local bank, he was frequently unable to get credit accommodation on any terms when his bank was hard-pressed for funds.

No consensus of opinion could be secured in Congress as to what legislation was necessary to remedy these rural credit defects. Even the "agricultural bloc" could not come to any agreement upon this question.⁶ During the Congressional sessions of 1922 numerous rural credit bills were introduced into both houses of Congress. They ranged all the way from conservative bills, carefully worked out, to radical schemes for empowering the Treasury to make direct loans to the farmers. By and

⁶ In this connection, it is interesting to note that the management of none of the existing credit institutions wanted to assume the responsibility for administering a special intermediate rural credits system. The Federal Reserve Board was certain that the Reserve Banks had no place for special rural credits departments. The Farm Loan Board had a similar feeling regarding the Federal Land Banks. And when it came to making the War Finance Corporation a permanent institution, its director, Eugene Meyer, Jr., was positive that it was not suited at all for the purpose.

large, the most important of these bills may be classified into three general groups:

1. Those that provided for the establishment of additional rural credit machinery around the Federal Land Banks.

2. Those that aimed to continue the War Finance Corporation in a modified form as a permanent rural credit institution.

3. Those that would amend the Federal Reserve Act so that the facilities of the Reserve Banks could be made more available to the farmers' local credit institutions.

During the third session of the 67th Congress no definite action was taken upon any of these various bills. President Harding, in his message to Congress at the opening of the fourth session, stressed the need of passing some rural credits legislation before adjournment. He did not, however, come out in favor of any one particular measure. During this session the controversy centered mainly around two bills—the Lenroot-Anderson bill, which we have previously mentioned, and the Capper-McFadden bill. The other bills which had been introduced gradually receded into the background, although parts of them were later included in the Agricultural Credits Act as finally passed.

III. RECOMMENDATIONS BASED UPON THE EXPERIENCE OF THE WAR FINANCE CORPORATION

The Capper-McFadden bill was drawn by Eugene Meyer, Jr., managing director of the War Finance Corporation, and was based upon the experience which he had had in directing the agricultural credit activities of this organization. Mr. Meyer had come to the conclusion that the Federal Reserve system could be made to take care of all the credit needs of the farmer for both

producing and marketing. In his opinion about the only type of farming that needed a special credit institution was the livestock industry. For this industry he provided for the organization of special credit institutions under the name of National Agricultural Credit Corporations.

Mr. Meyer insisted that if the Federal Reserve Act were amended so that the Reserve Banks could discount agricultural paper of nine-month maturity, and so that small country banks with a capital of less than \$25,000 could be permitted to join the Federal Reserve system, adequate credit facilities for the farmer would be provided.⁷ He particularly stressed the importance of the country banks becoming members of the Federal Reserve system. In this way he expected that the facilities of the Reserve Banks would be placed more freely at the farmer's disposal. In order to provide adequate accommodation for the co-operative marketing of the farmer's products, he advocated that the paper of co-operative marketing associations be classified as agricultural and given all the privileges pertaining to that class. The Capper-McFadden bill incorporated these ideas. It asked for no funds from the United States Treasury nor did it seek the privilege of issuing tax-free securities.

In contrast to the Capper-McFadden bill, the Lenroot-Anderson bill was framed with the idea that the Federal Reserve system was inadequate to take care of the intermediate credit needs of the farmers. It aimed to create a separate and independent discount system for agriculture, to be established in connection with, but independent of, the Federal Land Banks. The initial capital for starting this system was to be provided from the United States Treasury, and the funds with which it

⁷ For statement of Mr. Meyer's position see 67 Cong. 4 sess., *Rural Credits*, Pt. I, pp. 60-64.

was to finance its operation were to be provided through the sale of tax-free debentures. The essential difference between the two bills was that the Capper-McFadden bill aimed to liberalize and extend the powers of the Federal Reserve Banks and to strengthen and develop the existing country banks so that the whole banking system would be more useful and better adapted to meet agricultural requirements, while the Lenroot-Anderson bill was framed with the idea that the Federal Reserve system was insufficient for this purpose and that the establishment of a separate banking system for the exclusive use of agriculture was necessary.

IV. DIFFERENCE OF OPINION ON MERITS OF BILLS

Both within and without Congress the widest difference of opinion was held as to the relative merits of these two measures. The Capper-McFadden bill was strongly advocated by the spokesmen for the co-operative marketing associations and the livestock interests, while the Lenroot-Anderson bill received its greatest support from the agricultural sections of the Mid-West.

The co-operative marketing associations insisted that the present banking structure could be made to meet all their credit needs if only a few changes were made in our banking laws. The first thing that the co-operatives asked was that their paper be classified as agricultural rather than commercial in order that nine-month maturities might be acceptable for discount at the Federal Reserve Banks. The co-operatives insisted that they were not primarily mercantile organizations, but rather associations of farmers engaged in an essential agricultural occupation. From their point of view, credit advanced to enable farmers' co-operative associations to process, store, and market agricultural products was credit used

in an agricultural operation just as much as though it went to aid in the production of crops. Consequently, they insisted that their paper should be classified as agricultural paper.

The co-operative marketing associations did not ask for the establishment of special institutions, like Intermediate Credit Banks, to meet their credit needs. They took the position that if they had ready access to the sources of capital in our existing banks they could be adequately financed. The following quotation clearly expresses this point of view:

We do not, therefore, want new governmental bodies set up for the purpose of giving farmers access to government funds. We want the right to tap the present existing resources of the commercial money of the United States—to tap them in a way that will make them serve the farming interests. . . . Our reliance is practically wholly on existing banks and the existing Federal Reserve system. We believe that the existing banks and the Federal Reserve system can be made to meet to 100 per cent the needs of agriculture.⁸

The position of the co-operative marketing associations was essentially a conservative one. They did not ask for government owned banks to be established to finance their undertakings. They thought that the provisions of the Capper bill would alter our banking system sufficiently to meet all their credit needs and went on record as being in favor of its enactment. While they did not actively oppose the passage of the Lenroot-Anderson bill, they were only mildly interested in it.

The American National Livestock Association advocated the passage of the Capper-McFadden bill. Fred H. Bixby, president of the association, testified that what

⁸ Statement of Aaron Sapiro, the same, Pt. II, pp. 279, 285.

the industry needed most was some method of enhancing the security back of loans. When this was done, he felt certain that sufficient capital could be brought into the industry at reasonable rates to meet all the credit needs of the cattlemen. He held that if the Federal Reserve Act was amended so that cattle paper with a maturity of nine months could be rediscounted with the Reserve Banks, the credit problem of the cattle feeders would be solved.

When it came to loans to finance the range cattle industry, Mr. Bixby admitted that special financing institutions had to be organized for this purpose. Institutions of this character, namely, the cattle loan companies, were already in existence. The chief difficulty at this time was that so many of them were in an insolvent condition. The great price decline following the war had been preceded in the cattle-raising district by a period of careless loaning and followed by severe droughts, both of which had caused the losses in cattle paper to be especially large. This had ruined a good many cattle loan companies, had destroyed the market for cattle paper, and was making it almost impossible for the ranchmen to secure funds at reasonable rates of interest.

However, if means could be provided whereby the industry could improve the security for its loans and provide for a better system of negotiating them, Mr. Bixby felt certain that the livestock men would receive all the credit they required at rates of interest commensurate with those paid by other business men on similar loans.

The members of the American National Livestock Association were in favor of the Capper bill. They felt that the changes which this bill would make in the regu-

lar banking system, together with such encouragement as it gave for the organization of cattle loan companies, would satisfactorily meet all their credit requirements.

A majority of the farmers' organizations were in favor of the Lenroot-Anderson bill. The American Farm Bureau Federation indorsed it, as did the National Grange and the Farmers' Union. These organizations took the position that the Capper bill was not a rural credits measure applicable to the credit needs of all the farmers, but that it was drawn up primarily to serve the co-operative marketing associations and the cattle industry. They felt that the Lenroot-Anderson bill promised the farmer lower interest rates and longer maturities than did the Capper bill. Inasmuch as the intermediate credit banks provided for by the Lenroot-Anderson bill were to be established by the government and had the privilege of issuing tax-free securities, it was only reasonable to expect that they could furnish cheaper credit to the farmers than could the regular commercial banks. As the former were to be empowered to make loans from six months to three years, this would make credit available to the farmers for as long a period as they could possibly need. Because of these provisions, the farm organizations and the greater part of the agricultural press were in favor of the Lenroot-Anderson bill.

Even the President's Cabinet was divided as to the merits of the two bills. The Secretary of Agriculture came out very strongly in favor of the Lenroot-Anderson bill, while the Secretary of the Treasury was as strenuously opposed to it. The Secretary of Commerce, although he was of the opinion that the need for additional rural credit facilities was greatly exaggerated, expressed himself as being in favor of the Lenroot-Anderson bill.

In a letter to the chairman of the House Committee on Banking and Currency, the Secretary of the Treasury opposed the enactment of the Lenroot-Anderson bill on the ground that "its financial provisions were unsound and dangerous and its administrative features unworkable." In addition to this, he objected to the bill because it contemplated the government ownership and operation of an agricultural banking system and would increase the amount of tax-free securities in the country. Secretary Mellon was of the opinion that the best thing Congress could do was to enact into law the Capper bill and withhold action on the Lenroot-Anderson bill. He said he was convinced that in the long run the present banking system, modified and liberalized along the lines provided by the Capper bill, would serve the needs of agriculture far better than any rival system built upon government capital and under government administration and control.

Secretary Wallace of the Department of Agriculture held just the opposite view. In an open letter which he gave to the press on February 23, 1923, he characterized the Capper bill as not being a rural credits measure in the usual meaning of the term but as being a bill designed merely to encourage by governmental authority the organization of private credit corporations to be operated for a profit by their stockholders. He said that it was doubtful if the Capper bill would be of any service to the agricultural interests of the country, with the possible exception of the range cattle industry and the co-operative marketing associations. He closed his letter with the statement:

I can see no strong objection to the enactment of the Capper bill also, but to offer the latter as a rural credits bill or a substitute for the Lenroot-Anderson bill would give the farmers

of the nation the best of reasons for feeling that in reply to their request for bread they had been offered a stone.

During January the Senate passed both these bills, while at the same time the House passed a third rural credits bill. So tenaciously did each group hold to its own opinion that nothing was accomplished throughout the month of February. On the first of March, the House combined into one measure, and passed, the Lenroot bill, the Capper bill, and a bill it had previously passed, known as the Strong bill. A joint committee of both houses was then appointed to reconcile the Senate and the House bills. The time was so short and the conflict of interest between the various groups so keen that this committee was unable to draw up a unified rural credits measure. What it did was to amalgamate all the various bills into one by the simple process of connecting them end to end with only a little attempt at smoothing off the edges. Then it sent this omnibus bill back to Congress. During the closing hours of the last session of the 67th Congress, both houses by overwhelming majorities passed this measure as the Agricultural Credits Act of 1923, and on March 4 President Harding signed the bill and it became a law.

Various senators and representatives freely admitted at the time that they did not know what the significance of this legislation would be. The political exigencies of the moment demanded some sort of rural credit legislation, and as no agreement could be secured as to what was needed, Congress in an attempt to please all factions passed practically every bill that was before it.

CHAPTER IV

STRUCTURE OF THE INTERMEDIATE CREDIT SYSTEM

The Agricultural Credits Act of 1923 established two fundamentally different systems of agricultural credit which were expected to operate quite independently of each other. The Federal Intermediate Credit Banks form a central banking system for agriculture, owned, operated, and controlled by the national government. The National Agricultural Credit Corporations, provided for in the second plan, are private enterprises receiving no financial aid from the government. While the establishment of the Federal Intermediate Credit Banks is mandatory, the promotion of National Agricultural Credit Corporations is left entirely to private initiative. The government's only relation to them is a supervisory one through the office of the Comptroller of the Currency.¹

A brief survey of the structure of these two systems, of the type of business contemplated for each, and of the variance in administrative provisions reveals duplication of functions and emphasizes certain competitive advantages of each which have largely determined their respective importance in furnishing intermediate credit to agriculture.

I. THE FEDERAL INTERMEDIATE CREDIT BANKS

Under the provision of Title I of the Agricultural Credits Act of 1923, which contains with only minor changes the recommendation of the Joint Commission

¹ In order to give the National Agricultural Credit Corporations access to Federal Intermediate Credit Bank funds, the Agricultural Credits

of Agricultural Inquiry, twelve district banks known as Federal Intermediate Credit Banks are created. When the Act was passed it was felt that from an administrative point of view it was desirable to connect these new banks either with the Federal Reserve system or with the Federal Farm Loan system. It was finally decided to attach them to the existing rural credits agency—the Federal Farm Loan system. In this way it was thought that an organization could be maintained at very little expense during periods when there was little demand for the services of these banks. During credit stringencies, however, when an unusual demand for intermediate credit might arise, or as the business during normal times gradually increased, the organization could easily be expanded and the banks put in a position to take care of a larger volume of business.

These twelve Intermediate Credit Banks are located in the same cities as are the twelve Federal Land Banks, and the districts for the Intermediate Credit Banks are identical with those of the Land Banks. The officers and directors of the Land Banks are made *ex officio* the officers and directors of the Intermediate Credit Banks. In actual practice, however, special officers have been appointed to direct the work of the latter, and in every respect the operations and accounts of the two systems are kept separate. The Federal Farm Loan Board has supervision over the Intermediate Credit Banks, and, subject to the provisions of the Agricultural Credits Act, it makes such rules and regulations as it thinks necessary for the conduct of their business.

The Intermediate Credit Banks are government institutions. Their establishment was made mandatory by

Act was amended on Mar. 4, 1925 so as to include these corporations among the financing institutions for which the Intermediate Credit Banks could discount paper.

Act of Congress, and the Secretary of the Treasury was directed to subscribe to their capital stock in such amounts as called for by the directors of the banks, not in excess of 5 million dollars for each bank. To secure such additional funds as may be needed in the conduct of their business, the Intermediate Credit Banks are empowered to issue and sell collateral trust debentures secured by agricultural and livestock paper.² These debentures enjoy the same tax exemptions as the Federal Farm Loan bonds. The United States government, however, assumes no liability for them. Each bank is liable for the principal and interest on its own debentures and has a contingent liability on all the debentures issued by the other banks.³

Discount rates are fixed by the Intermediate Credit Banks, subject to the approval of the Federal Farm Loan Board. After debentures have once been issued, the rate of discount of any bank cannot exceed by more than 1 per cent the rate borne by the last issue of debentures. Thus these banks must work on a margin of 1 per cent. As the government owns the Intermediate Credit Banks, the profits from their operation go to the United States Treasury. Originally one-half their net earnings was to be placed in a surplus fund until this account equalled 100 per cent of the banks' subscribed capital stock. Later

² The Agricultural Credits Act amended Section 13 of the Federal Reserve Act, permitting Reserve Banks to rediscount eligible agricultural paper for the Federal Intermediate Credit Banks. An amendment of May 19, 1932 permits the Reserve Banks to discount notes payable to and bearing the indorsement of any Federal Intermediate Credit Bank secured by agricultural paper eligible for rediscount.

The amendment of May 19, 1932 also authorizes the Intermediate Credit Banks to accept drafts drawn by co-operative associations when secured by warehouse receipts or shipping documents.

³ The situation in respect to the liability of each Intermediate Credit Bank for the debentures and interest payments of all banks was modified somewhat by the amendment of May 19, 1932. See Chap. XII.

only 10 per cent of the net earnings was to be added to surplus and the rest was to go to the United States Treasury as a franchise tax. An amendment of May 19, 1932 provides that even after the surplus equals 100 per cent of the subscribed capital 50 per cent of the earnings shall be added to surplus and the balance paid to the Treasury.⁴ In case of liquidation, after all outstanding debts have been paid the net assets of the banks become the property of the federal government.

The Intermediate Credit Banks do not make loans directly to the farmers. From an administrative point of view, it is very difficult for a central institution operating over several states to make short-time loans without the aid of local credit organizations. The following provisions of the Agricultural Credits Act enumerate the institutions for which the Intermediate Credit Banks may discount paper and the purposes for which the proceeds may be used.

1. To discount for, or purchase from, any national bank, and/or state bank, trust company, agricultural credit corporation, incorporated livestock loan company, savings institution, co-operative bank, co-operative credit or marketing association of agricultural producers, organized under the laws of any state, or of the government of the United States, and/or any other Federal Intermediate Credit Bank, with its indorsement, any note, draft, bill of exchange, debenture, or other such obligation the proceeds of which have been advanced or used in the first instance for any agricultural purpose or for the raising, breeding, fattening, or marketing of livestock; and to make loans or advances direct to any such organization, secured by such obligations.

⁴The amendment provides that "whenever the surplus thus paid in shall have been impaired, it shall be fully restored before payment of the franchise tax herein prescribed."

See Appendix A for net earnings and the transfers to surplus for the twelve banks from organization to December 1932.

Farmers are given every possible means of securing funds from the Intermediate Credit Banks, except the right to borrow directly from them. As a concession to those who believed that farmers needed a way of securing funds without having to rely upon local banks, the Intermediate Credit Banks were empowered to discount paper for incorporated agricultural credit corporations and livestock loan companies. By forming such associations a group of farmers may secure loans from the Intermediate Credit Banks without the aid of commercial banks. The financing institutions to which producers may go for loans in the first instance are: (1) commercial banks; (2) trust companies and savings banks; (3) livestock loan companies; (4) agricultural credit corporations; and (5) co-operative banks and co-operative credit associations. Since the Intermediate Credit Banks stand ready to purchase or discount paper for any of these institutions, producers have numerous channels through which to secure outside funds.⁵

Originally financing institutions could obtain funds from the Intermediate Credit Banks only through rediscounting individual farmers' notes. But an amendment of June 26, 1930 simplifies the process of borrowing by permitting financing institutions eligible for discount privileges to borrow on their own notes payable secured by paper that is eligible for discount. This provision allows greater flexibility in pledging and substituting collateral than was the case when individual farmers' notes were rediscounted.

⁵ The Agricultural Credits Act authorizes discounts for co-operative banks and co-operative credit associations, but these organizations are of slight importance in this country. Moreover, since they are usually non-stock organizations, the permission to discount with the Intermediate Credit Banks is of no practical importance because only capital stock organizations can qualify for discount privileges.

The privilege of rediscounting with the Intermediate Credit Banks carries with it the obligation to adjust customers' rates in accordance with the discount rate paid. Congress not only enumerated a variety of financing institutions through which customers could be accommodated but also undertook to dictate the terms on which they serve their customers. The Act stipulated that on all discounted paper a borrower should not be charged more than 1.5 per cent per annum above the discount rate of the Intermediate Credit Bank at the time the loan was made except with the express approval of the Farm Loan Board.

Acting in its discretionary capacity the Farm Loan Board has increased this spread at different times. On January 7, 1924 it authorized a 2 per cent margin for all types of loans, and on January 31, 1925 this margin was increased to 2.5 per cent for the livestock loans, on the assumption that the costs and hazards of livestock financing warranted a wider spread. Again in April 1931 the Farm Loan Board reconsidered the question of operating margins and authorized a 3 per cent spread on all loans regardless of their collateral security.⁶ Inasmuch as the Intermediate Credit Banks are not permitted to set discount rates at more than 1 per cent above their debenture rates, and since the Farm Loan Board must approve any increase in the gross margins allowed local discounting institutions, any easing in the general credit situation presumably is reflected in customers' rates.

The volume of paper which local financing institutions may rediscount with a given amount of capital is subject to certain restrictions. The maximum amount of dis-

⁶ *Annual Report of the Federal Farm Loan Board, 1931, p. 53.*

counts for any banking institution is twice its paid-in and unimpaired capital and surplus. Agricultural credit corporations and livestock loan companies, which have no deposit liabilities, are allowed a more generous loan expansion. They may rediscount not in excess of ten times their paid-in and unimpaired capital and surplus.⁷

Thus in the legal provisions of the Agricultural Credits Act in respect to the discount of agricultural paper by Intermediate Credit Banks, Congress was chiefly concerned with the provision of numerous channels through which funds might be drawn into agricultural communities, lower interest rates for borrowers, and a moderate pyramiding of capital resources on the part of local discounting institutions.

In addition to discounting producers' notes and the paper of financing institutions secured by such notes, the Intermediate Credit Banks are authorized to make loans direct to co-operative associations composed of persons

⁷ "No paper shall be purchased from or discounted for any national bank, state bank, trust company, or savings institution under this section, if the amount of such paper added to the aggregate liabilities of such national bank, state bank, trust company or savings institution, whether direct or contingent (other than bona fide deposit liabilities), exceeds the amount of such liability permitted under the laws of the jurisdiction creating the same; or exceeds twice the paid-in and unimpaired capital and surplus of such national bank, state bank, trust company, or savings institution. No paper shall under this section be purchased from or discounted for any other corporation engaged in making loans for agricultural purposes or for the raising, breeding, fattening, or marketing of livestock, if the amount of such paper added to the aggregate liabilities of such corporation exceeds the amount of such liabilities permitted under the laws of the jurisdiction creating the same; or exceeds ten times the paid-in and unimpaired capital and surplus of such corporation. It shall be unlawful for any national bank which is indebted to any Federal Intermediate Credit Bank upon paper discounted or purchased under this section, to incur any additional indebtedness, if by virtue of such additional indebtedness its aggregate liabilities, direct or contingent, will exceed the limitations herein contained." "Text of Law Providing for Federal Intermediate Credit Banks," *Federal Farm Loan Board Circular No. 15*, p. 3.

engaged in producing or producing and marketing staple agricultural products or livestock. From the outset agricultural leaders insisted that there was as much need for longer maturities in financing the marketing of farm products as there was in financing their production. In fact it was the marketing of farm products through co-operative associations which gave rise to one of the needs for intermediate credit in agriculture. When the farmer sold his products as soon as they were harvested he could promptly liquidate his loans. However, as he began to form large co-operative associations to sell them gradually throughout the year, he was forced to make his production loans for a longer time because he did not get the money from the sale of his products so soon after harvest. If co-operative marketing associations were to function as effective sales agencies, they required loans sufficient to cover first advances to their members and to enable them to market the commodity throughout the season in response to consumption demands. To meet this need for credit the Agricultural Credits Act authorizes the Intermediate Credit Banks:

3. To make loans or advances direct to any co-operative association organized under the laws of any state and composed of persons engaged in producing, or producing and marketing, staple agricultural products, or livestock, if the notes or other such obligations representing such loans are secured by warehouse receipts, and/or shipping documents covering such products, and/or mortgages on livestock; *provided*, that no such loan or advance shall exceed 75 per centum of the market value of the products covered by said warehouse receipts and/or shipping documents, or of the livestock covered by said mortgages; and to accept drafts or bills of exchange issued or drawn by any such association when secured by warehouse receipts and/or shipping documents covering staple agricultural products as herein provided.

Originally the Intermediate Credit Banks were not permitted to make loans for less than six months or more than three years. By restricting their maturities it was thought they would not trespass on the province of commercial banks in supplying short-time working capital. Their particular function was to furnish a type of credit presumably not suitable because of its term for either commercial or investment banks. An arbitrary distinction on a time basis was accepted in order to differentiate their respective fields. Only loans with maturities of six months to three years were classed as intermediate credit. In response to urgings from those co-operative associations and financing institutions whose members and customers required loans for less than six months, the Act was amended on June 26, 1930 so as to authorize loans of any maturity not to exceed three years. Whether broadening the scope of eligible maturities will materially increase the use of the Intermediate Credit Banks remains to be seen, but at least they are now free to serve the entire range of short-term agricultural requirements.

Co-operative associations of the non-stock type cannot indorse the personal notes of their farmer members and rediscount them at the Intermediate Credit Banks. Discount privileges are specifically reserved to capital stock corporations. While the Intermediate Credit Banks may, under the law, purchase farmers' notes from capital stock co-operative associations under the same conditions as they do from agricultural credit corporations, in practice they have not found such business acceptable credit risks. Hence the only access which co-operative associations have to Intermediate Credit Bank funds for the benefit of their members or patrons is through the medium of incorporated discount corporations.

In summarizing the loan functions of the Intermedi-

ate Credit Banks we find them serving in two distinct capacities: as a central discount system for agriculture and as a source of direct loans to co-operative marketing associations secured by negotiable shipping documents or by warehouse receipts based upon non-perishable, readily marketable agricultural products.⁸ Through the discounting process funds are made available for "any agricultural purpose or for raising, breeding, fattening, or marketing livestock." But even with this comprehensive role assigned to the Intermediate Credit Banks, a second title was included in the Agricultural Credits Act providing additional intermediate credit institutions.

II. NATIONAL AGRICULTURAL CREDIT CORPORATIONS

The credit institutions provided for in the Capper-McFadden bill were to be known as National Agricultural Credit Corporations. As the Agricultural Credits Act was originally passed, these corporations had no connection with the Intermediate Credit Banks but, by amendment on March 4, 1925, the Intermediate Credit Banks were authorized to discount paper for them.

The Congressional debates indicate an intention to establish a distinct kind of credit institution having its own place and distinctive work in our credit structure.⁹ Congress was guided largely by the experience of the War

⁸ The Act permits direct loans secured by mortgages on livestock, but no direct advances have been made to co-operative livestock marketing associations.

Whenever the term "direct loans" is used it refers to loans to co-operative marketing associations secured by warehouse receipts or shipping documents representing staple agricultural products as defined by the Federal Farm Loan Board.

⁹ "We have tried to create institutions that would function independently of each other and meet fully the requirements of the agricultural interests of the country." Hon. Louis T. McFadden, chairman, House Committee on Banking and Currency, *Cong. Record*, Vol. 64, Pt. V, p. 5559.

Finance Corporation in making agricultural and livestock loans. The leaders of this group were convinced that, with the exception of the livestock industry, our regular banking system could adequately meet the intermediate credit needs of agriculture. However, the financial requirements of the livestock industry are such that a special type of credit institution was recommended—the National Agricultural Credit Corporations provided for in the Capper-McFadden bill.¹⁰ These institutions are subject to federal control and their supervision is placed in the office of the Comptroller of the Currency. This official exercises the same powers over them as he does over national banks. He charters them, regulates their loaning operations, and supervises their accounts.

Indiscriminate granting of charters for the organization of National Agricultural Credit Corporations is not permitted. Just as charters for the organization of national banks are frequently denied, so it is the intent of the law that no permit to form a National Agricultural Credit Corporation in a state shall be granted (1) where no economic need justifies it, and (2) where the laws of a state do not afford adequate protection for loans made on the basis of warehouse receipts or chattel mortgages. If loans are made on livestock on the ranges, it is very important that the state laws governing the recording of mortgages as well as of brands or other identification marks be definite and specific. If they are not, the danger is always present that dishonest

¹⁰ While the National Agricultural Credit Corporations were designed primarily to finance the livestock industry, their form of organization is also well adapted to the requirements of the co-operative marketing associations. Consequently they were empowered to make advances to these organizations.

stockmen will try to evade their just obligations. The risks of conducting credit institutions under these conditions are too great to permit their organization. This is especially true because the failure of one of these institutions may involve loss to others and thus undermine the public confidence which is essential if they are to function properly.¹¹

Sufficient capital stock is required to insure a responsible credit institution. No corporation is permitted to commence business without a paid-in capital of at least \$250,000. And no matter how large the authorized capital stock, at least 50 per cent of it must be paid in cash before the company can enter into any business. It is further provided that the remainder of the capital stock must be paid in within six months from the date that the Comptroller of the Currency authorizes the corporation to commence business. The capital stock may be increased on demand from time to time by a two-thirds vote of the stockholders, but in no event can it ever be reduced to less than \$250,000. It was felt that it was necessary to have this minimum in order to make the indorsement of a National Agricultural Credit Corporation a reliable one. Inasmuch as livestock loans are usually large loans, only an institution with a large capital can make them with safety.

¹¹ The real difficulty that prevented adequate financing of the range cattle industry during the depression of 1920-25 was that the investing public had lost faith both in a good many of the existing cattle loan companies and in the cattle paper they issued. As a result, the sources of funds that usually went into this industry dried up. If such an occurrence is to be prevented in the future, permission must not be granted to form new credit institutions in any locality where the conditions under which they are compelled to carry on their business are such that a safe credit transaction cannot be conducted. The framers of the Act hoped to encourage the livestock organizations to take the initiative in improving some of the existing state laws in these respects.

It was hoped that the banks which were interested in financing the livestock industry would furnish the greater amount of the capital necessary to organize these corporations. Consequently, member banks of the Federal Reserve system, subject to the approval of the Comptroller of the Currency, are permitted to invest an amount not exceeding 10 per cent of their capital and surplus in the stock of a National Agricultural Credit Corporation. Although it was expected that the connection between the stockholding banks and a credit corporation would necessarily be close, it was provided that the business affairs of the corporation must be kept separate. The War Finance Corporation had found that many of the bad credit practices in livestock financing grew out of the fact that banks frequently operated cattle loan companies as adjuncts to their main business. In many cases, this resulted in the operations of a cattle loan company and a bank becoming so mixed up that it was impossible to exercise effective supervision over either institution. The National Agricultural Credit Corporations were designed to be separate and independent institutions so that this old trouble would not recur.

The loaning powers of the National Agricultural Credit Corporations are carefully safeguarded. They are authorized to make advances or discount paper or accept drafts of the following nature:

1. Paper having a maturity not exceeding nine months and secured by chattel mortgages on livestock which is being fattened for market.
2. Paper having a maturity not exceeding nine months and secured by warehouse receipts representing non-perishable agricultural commodities.

3. Paper secured by agricultural crops being grown for market.¹²

4. Paper having a maturity not exceeding three years and secured by chattel mortgage on maturing, breeding, or dairy herds.

As the National Agricultural Credit Corporations were designed to attract capital into the livestock industry by enhancing the security of livestock paper rather than by offering high interest rates, their loaning practices had to invite confidence in their paper. In the first place, if their indorsements were to be relied upon, it was imperative that a limit should be fixed on the amount of loans that a corporation could extend on a given amount of capital. This limit was fixed by restricting the liabilities, either direct or contingent, of any one of these corporations to ten times its unimpaired capital stock and surplus. This figure includes the sale or discount of paper bearing the corporation's indorsement.

Advances to one party are also limited. The amount of loans or acceptances that a corporation may have outstanding to any customer may never exceed 20 per cent of the capital and surplus of the corporation. The only exception to this general rule is where the loans are secured by warehouse receipts representing readily marketable agricultural commodities. Here, the total amount to one borrower may be as much as 50 per cent of the corporation's capital and surplus.

Careful inspection of all livestock collateral is required. Inadequate inspection when loans were being made has been one of the outstanding difficulties in

¹² National Agricultural Credit Corporations were authorized to make loans on the security of growing crops by an amendment of Feb. 8, 1927.

livestock financing. To remedy this condition a licensed system of livestock inspection was set up, patterned after the federal system of licensing government warehouses. The Secretary of Agriculture has the power to license competent persons to inspect all livestock pledged as collateral for loans. If any inspector makes any false statement in his inspection report he is punishable by a fine of \$5,000, or by imprisonment of not more than five years, or both. Thus by insuring accurate statements as to the number of animals and general ranch conditions, together with competent appraisal of collateral, it was hoped that the chief causes for losses on livestock loans would be removed.

In order to prevent a combination of merchandising and financing operations which might encourage laxity in credit accommodations, the law prohibits any corporation from purchasing, owning, or dealing in any livestock except when such livestock is taken in the course of liquidation of loans. Many of the old cattle loan companies frequently were in difficulties, not primarily through their loaning operations, but because of unwise ventures in cattle raising which they undertook for themselves. The law now requires that National Agricultural Credit Corporations engaged in financing shall not engage either in the buying and selling or the raising of livestock.

Minimum reserves kept on deposit with the Federal Reserve Banks are required of the National Agricultural Credit Corporations. Before one of these corporations opens for business it must make a deposit of United States government obligations with the Federal Reserve Bank of its district to the amount of 25 per cent of its paid-in capital stock. These securities are held in

trust for the protection and benefit of all holders of obligations on which the corporation may be directly or contingently liable. As the corporation expands its business it must add to this amount so that the value of these securities shall at all times be equal to at least 7.5 per cent of the aggregate indebtedness, direct or contingent, of the Credit corporation. And, irrespective of the amount of business done, this amount can never be less than 25 per cent of the corporation's capital. If at any time the amount of this deposit is less than this minimum, the corporation is not permitted to make any further loans, discounts, or acceptances until the deficiency has been remedied by the deposit of additional securities. This provision regarding reserves is another measure that was adopted in order to strengthen the faith that investors would have in the corporations' indorsements.

The law does not attempt to regulate the interest rates charged by National Agricultural Credit Corporations. They may charge the rate allowed by the laws of the state in which their principal office is located. Since capital was to be attracted into the livestock industry by improving the financial responsibility and loan practices of the credit corporations, they were left free to compete for investment funds without an arbitrary limitation on their charges to borrowers. It was felt that any attempt to compel by law low interest rates on hazardous loans would result only in keeping capital from entering the industry.

National Agricultural Credit Corporations are given the power to issue debentures. The conditions governing the issuance of debentures by these corporations are practically the same as those that govern the Intermedi-

ate Credit Banks, with the exception that the debentures of the credit corporations are not tax-exempt. The amount of debentures that any credit corporation can issue is limited by the stipulation that outstanding liabilities cannot exceed ten times its capital stock and surplus. The Comptroller of the Currency has general supervision over the issuance of these securities and none can be offered for sale without his permission. The market for these debentures would be the same as for those of the Federal Intermediate Credit Banks—private investors and commercial banks with short-term funds to invest. The Federal Reserve Banks are also empowered to buy them under the same conditions that they are permitted to purchase the debentures of the Federal Intermediate Credit Banks.

Thus far, however, National Agricultural Credit Corporations have issued no debentures. It is hardly to be expected that the securities of these independent corporations should be sold on the same terms as debentures issued by the Intermediate Credit Banks which are tax-exempt and the joint liability of all twelve banks, although primarily the liability of the issuing bank. The debentures of National Agricultural Credit Corporations are not tax-exempt and the issuing corporation is solely responsible for their payment. Since these corporations can now rediscount with the Intermediate Credit Banks at 1 per cent above whatever rate the latter's tax-exempt securities command in the investment market, there is no incentive for them to raise funds by issuing their own securities. Instead, they refinance through commercial banks in the livestock centers or rediscount with the Intermediate Credit Banks.

National Agricultural Credit Corporations may serve

as central discounting institutions. Any corporation with a capital of at least 1 million dollars is authorized to discount paper for another corporation or for a bank or trust company that is a member of the Federal Reserve system. Thus far, no corporation has functioned as a central discounting institution. There is no inducement to duplicate the facilities of the Intermediate Credit Banks, which serve as intermediaries between local credit corporations and the surplus investment funds of the open money market. Since the Intermediate Credit Banks have an advantage in the investment market because of issuing tax-exempt securities, and since they are required by law to charge their customers only 1 per cent above their debenture rate, it is quite unlikely that a second central discounting system for agricultural paper will be developed by private enterprise in competition with them.

Moreover, the establishment of the Intermediate Credit Banks makes it improbable that any large number of National Agricultural Credit Corporations will ever be organized to serve as local loan corporations. The provisions for organizing state agricultural credit corporations are so much more liberal that it is altogether likely that new credit institutions will continue to prefer to incorporate under state rather than national laws. Nor are existing cattle loan companies likely to reorganize under federal charter. Previous to March 4, 1925 they had nothing to gain by so doing. The Department of Justice had ruled that paper of National Agricultural Credit Corporations was not eligible for discount by the Federal Intermediate Credit Banks under Section 202 of the Agricultural Credits Act.¹³ Thus the

¹³ Decision handed down May 29, 1923 by Acting Attorney General A. L. Seymour upon inquiry of the Secretary of the Treasury.

favorable rates of the Intermediate Credit Banks would not have been available to state-incorporated cattle loan companies had they reorganized as National Agricultural Credit Corporations. Although the amendment of March 4, 1925 broadened the powers of the Intermediate Credit Banks to permit them to discount paper for National Agricultural Credit Corporations, this action has had no stimulating effect upon the formation of corporations under federal law. Inasmuch as legal regulations are more strict for these corporations than for state corporations, and since all corporations discounting with the Intermediate Credit Banks must conform to their rulings and are subject to examination by them, there is little reason to expect that many livestock companies will choose to comply with the more stringent requirements and elect to come under two supervisory agencies instead of one.¹⁴

Although the Agricultural Credits Act has been in effect ten years, only three National Agricultural Credit Corporations have been established, and only one of these was planned as a permanent venture. Two were emergency corporations organized to loan on warehoused corn in Iowa and enable farmers to avoid the disastrously low prices prevailing in the fall of 1926. After the emergency for which they were created had passed they went into voluntary liquidation. The Pacific National Agricultural Credit Corporation, organized in June 1925 to finance livestock producers, is the only one functioning at the present time. (See Chapter VI.)

Thus the plan of Congress that the Federal Intermediate Credit Banks and National Agricultural Credit

¹⁴ We have already commented on the unlikely chance that National Agricultural Credit Corporations with a million dollars capital will be organized to serve as central discount agencies.

Corporations should form two rural credit systems, each functioning in its separate sphere independently of the other, has not materialized. Instead, we have one Intermediate Credit system, based upon the twelve Intermediate Credit Banks which make direct loans to cooperative marketing associations and discount paper for commercial banks, agricultural credit corporations, and livestock loan companies incorporated under either state or federal law. Instead of the National Agricultural Credit Corporations forming an intermediate credit system in their own right, they are one type of loan institution for which the Intermediate Credit Banks discount paper. Structurally, the Agricultural Credits Act has given agriculture one rural credit system with a variety of channels through which funds are drawn into agricultural communities. It is with the operation of this system that Part II is concerned.

PART II
OPERATING EXPERIENCE

CHAPTER V

THE INTERMEDIATE CREDIT SYSTEM AND THE COMMERCIAL BANKS

After the Agricultural Credits Act was passed the Federal Farm Loan Board lost no time in setting up the twelve new banks. Early in 1923 they were chartered and ready for business. At that time only two types of financing institutions were available to connect producers with Intermediate Credit Bank funds. These were commercial banks and existing cattle loan companies. Almost immediately, however, additional livestock loan companies and agricultural credit corporations were organized to take advantage of this new source of credit. Postponing discussion of the latter types of credit institutions to a later chapter, we shall look first at the response of the commercial banks.

During the first two years the volume of loans discounted for commercial banks was fairly impressive. At the close of 1923 approximately 15 per cent of all discounts outstanding were for banking institutions. Even so, this represented less than 1.5 million dollars in loans, and dropped to 1 million in 1924. This was a disappointment to those who visualized the commercial banking system as the means by which producers were to be given ready access to the open money market and consequently to credit at low rates. However, it was followed by further declines, and it is now apparent that banks play an insignificant role in drawing Intermediate Credit Bank funds into their respective communities. This is shown in the accompanying tabulation of discounts outstanding at the close of the years

108 FEDERAL INTERMEDIATE CREDITS

DISCOUNTS FOR COMMERCIAL BANKS BY FEDERAL INTERMEDIATE CREDIT BANKS, 1923-32*

(Dollar items are in thousands)

Date	Total Discounts by the Inter- mediate Credit Banks	Discounts for Commercial Banks ^b	
		Amount	As Percentage of Total Discounts
December 31, 1923...	\$ 9,105	\$1,328	14.5
December 31, 1924...	18,759	1,008	5.4
December 31, 1925...	26,272	511	1.9
December 31, 1926...	39,730	345	0.9
December 31, 1927...	43,924	182	0.4
December 31, 1928...	45,103	328	0.7
1929: March 31.....	50,669	450	0.9
June 30.....	59,070	1,562	2.6
September 30...	55,343	2,072	3.8
December 31...	50,018	2,091	4.2
1930: March 31.....	56,284	1,408	2.5
June 30.....	64,641	664	1.3
September 30...	65,691	2,298	3.5
December 31...	65,633	2,378	3.6
1931: March 31.....	75,730	1,831	2.4
June 30.....	79,206	1,206	1.3
September 30...	81,121	1,947	2.4
December 31...	74,613	1,877	2.5
1932: March 31.....	74,346	1,113	1.5
June 30.....	80,462	537	0.7
September 30...	82,875	1,402	1.7
December 31...	82,518	1,994	2.4

* Year-end figures are from *Annual Reports of the Federal Farm Loan Board 1923-32*. Other quarterly figures are from *Statements of Condition of Federal Land Banks, Joint Stock Land Banks, Federal Intermediate Credit Banks, Federal Farm Loan Bureau*, U. S. Treasury Department.

^b Discounts for savings banks and trust companies are included but form a negligible part of the total. Loans made directly to banks on the security of their own notes payable are included.

1923-28 and at quarterly intervals for the last four years.

The proportion of discounts indorsed by banks dropped rapidly after the first two years until at the

close of 1928 less than 1 per cent of the discounts originated with banking institutions. With the tighter money markets in 1929 and the uneasy banking situation which followed the stock market crash, discounts for banks increased, but even at the peak of borrowings in the winter of 1930 less than 2.5 million dollars were loaned. Nevertheless the reluctance of city banks to accommodate their country correspondents forced a number of banks, chiefly non-member state banks, to open accounts with the Intermediate Credit Banks during these years.

The table on page 110, showing accounts opened from the date of organization to December 31, 1932 and their status at the close of 1929 and 1932, reveals the transitory character of discount relationships, especially during the early years. This statement is particularly true for the accounts of commercial banks. A comparison of the number of banks rediscounting paper with the number of agricultural credit corporations and livestock loan companies indicates that commercial banks are of minor importance as intermediaries between producers and the Intermediate Credit Banks even in periods of serious banking stress.

One-fourth of all the banks rediscounting with the Intermediate Credit Banks up to December 1929 subsequently failed, but the majority discontinued their relationship for less obvious reasons. Many commercial banks, particularly those in the livestock areas, had non-liquid and poorly secured paper in their portfolios which they wished to transfer to the Intermediate Credit Banks. Before the commercial banks were fully informed as to the credit standards which the Intermediate Credit Banks demanded, many of them had qualified for lines of credit only to learn that a very small por-

FINANCING INSTITUTIONS SERVED BY THE FEDERAL INTERMEDIATE CREDIT BANKS*
I. Commercial Banks, Savings Banks, and Trust Companies

Type of Institution	From Organization to December 31, 1929					Accounts Active December 31, 1929	New Accounts			Number Served to December 31, 1932	Accounts Active December 31, 1932 ^b
	Number Served	Number Failed	Ceased Dis-counting for Other Reasons	Temporarily or Seasonally Not In-debted	1930		1931	1932			
State Banks.....	157	42	88	14	27	20	—	—	—	—	
National Banks.....	12	1	8	2	2	1	—	—	—	—	
Savings Banks and Trust Companies...	10	1	6	3	1	1	—	—	—	—	
Others.....	1	—	1	—	—	—	—	—	—	—	
Total.....	180	44	103	19	30	22	14	246	28		

II. Livestock Loan Companies and Agricultural Credit Corporations

Livestock Loan Companies.....	98	13	203	5	9	29	164	129
Agricultural Credit Corporations.....	415	26	25	31	60	144	655	273
Total.....	513	39	228	36	69	173	819	402

* Data were obtained from the Statistical Division of the Federal Farm Loan Bureau.

^b Active accounts refer to all financing institutions indebted to the Intermediate Credit Banks on Dec. 31, 1932.

tion of their offerings were acceptable. The banks most anxious to rediscount paper were facing financial difficulties, in many cases bordering upon insolvency, and so their indorsement on any quantity of paper was an insufficient guaranty for the Intermediate Credit Banks. Consequently many accounts in the livestock areas were short-lived affairs and the paper purchased negligible in amount. In the Wichita District 24 banks had opened and permanently closed their accounts before the end of 1925. None of these banks was advanced loans exceeding a total of \$60,000, while the average line of credit was around \$15,000.¹ A similar haste to qualify for discount privileges, followed by a marked decline in rediscounting by commercial banks, occurred in the St. Paul and Omaha Districts. Banks experiencing financial difficulties were dubious credit risks and were served sparingly, while those with high-grade liquid collateral were quite indifferent to the new system.

This indifference of solvent commercial banks to a special discount system for agricultural paper arises from two general causes. In the first place the Intermediate Credit Banks are largely superfluous for seasonal accommodations since the Reserve Banks and correspondent banks are more convenient and offer more attractive terms. And in the second place legal restrictions upon interest rates charged borrowers and the limits upon maximum discounts leave little profit inducement for banks to expand permanently on funds borrowed from the Intermediate Credit Banks.

Country banks with satisfactory credit standing have no incentive to change their credit affiliations so long as they can borrow from their regular correspondent

¹ Data were obtained from the Wichita Intermediate Credit Bank.

banks or rediscount with the Federal Reserve Banks. At no time since the Intermediate Credit Banks were established has there been a period of general credit shortage which has forced solvent banks with liquid portfolios to look elsewhere than to their customary sources for seasonal accommodations. However, in 1929, when call rates were very attractive, and from 1930 to 1932 when all banks were attempting to achieve a highly liquid position, commercial banks rediscounted a larger volume of paper than at any other time. Non-member banks found their city correspondents less ready to accommodate them on their bills payable or to give them indirect access to Reserve Bank credit, because city banks felt it advisable to strengthen their own position in the event of unexpected withdrawals of cash. If normal sources of credit had remained open, it is quite unlikely that many banks would have shifted their accounts, since the terms of credit offered by Reserve Banks or correspondents are more attractive than those of the Intermediate Credit Banks.

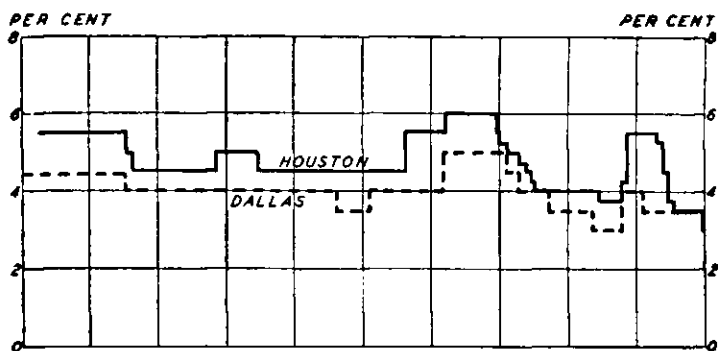
Discount rates of the Intermediate Credit Banks have ordinarily been higher than Reserve Bank rates in the same section. In those districts where discounts are of greatest importance commercial banks can borrow from the Reserve Banks directly, or indirectly through their correspondent banks, at rates ranging from one-fourth of 1 per cent to 1.5 per cent below the Intermediate Credit Bank rates. The chart on page 113 shows conclusively the advantage of the former over the latter as sources of funds for seasonal loans.²

Prior to 1930 Reserve Bank rates, with the exception of a few months in 1928, ranged three-fourths of

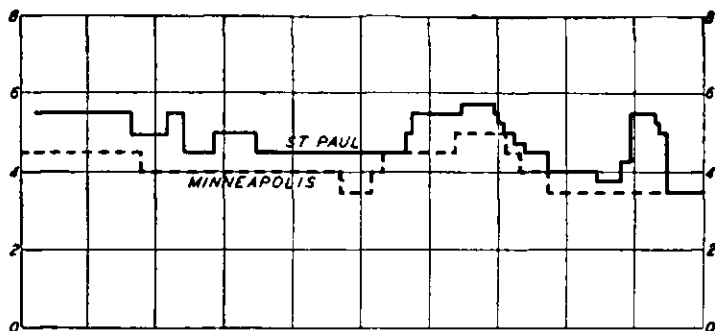
² Reserve districts and Intermediate Credit Bank districts do not coincide exactly, but include similar areas.

DISCOUNT RATES OF INTERMEDIATE CREDIT BANKS AND FEDERAL RESERVE BANKS COMPARED, 1923-32

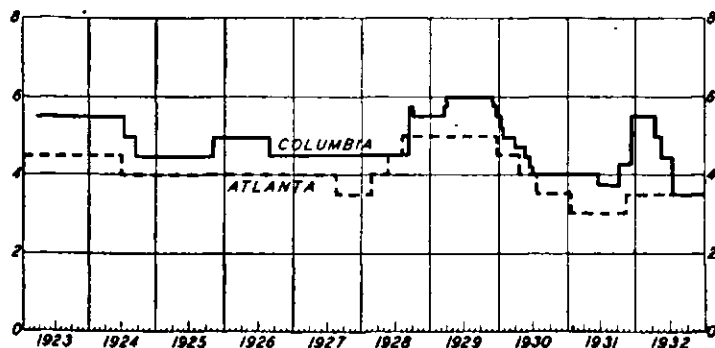
I. Houston Intermediate Credit Bank and Dallas Reserve Bank



II. St. Paul Intermediate Credit Bank and Minneapolis Reserve Bank



III. Columbia Intermediate Credit Bank and Atlanta Reserve Bank



1 per cent or more below the discount rate of the Intermediate Credit Banks. In the Southwest livestock areas and in the North Central states, where mixed farming predominates, a differential of three-quarters of 1 per cent to 1 per cent was usual. But during 1930 and 1931 the spread between Intermediate Credit Bank rates and Reserve Bank rates at no time exceeded one-half of 1 per cent, and on December 31, 1932 the St. Paul and Columbia Intermediate Credit Banks were discounting paper at the same rates as the Minneapolis and Atlanta Reserve Banks while the discount rate of the Houston Intermediate Credit Bank was below the rate at the Dallas Reserve Bank. If Reserve Bank funds are available at more favorable rates than Intermediate Credit Bank funds, the tendency for member banks to depend upon Reserve Banks for seasonal requirements is encouraged. Even though rates on loans from correspondent banks have been somewhat higher than the prevailing discount rate of the Intermediate Credit Banks, this price differential has not been sufficient to encourage many banks whose credit status entitled them to borrow from their regular correspondents to go elsewhere.

Neither do the maturities eligible for discount by the Intermediate Credit Banks offer sufficient inducement to cause banks to change their source of borrowings. Although three-year maturities are authorized, in practice livestock loans are drawn to mature within nine months or at most a year, with the privilege of renewal if a re-appraisal of the collateral warrants. Crop loans are drawn to mature at harvest time, normally within six or eight months.³ Agricultural loans having nine-

³ An examination of maturity dates for a number of corporations leads to the conclusion that seven- and eight-month maturities are most common.

month maturities may be discounted by the Reserve Banks, for the Federal Reserve Act was amended to this effect by the same Act which created the Intermediate Credit Banks.

The Reserve Board has been even more lenient in its definition of agricultural paper than has the Farm Loan Board. A farmer's note, although presented by a merchant, is defined by the Reserve Board as agricultural paper if the proceeds are used for an agricultural purpose. The Farm Loan Board has ruled that notes given by farmers to commercial concerns for the purchase of farm supplies, machinery, and fertilizer are for commercial rather than agricultural purposes and cannot be discounted by the Intermediate Credit Banks. Thus by legislative provisions and administrative rulings the field specifically reserved for the Intermediate Credit Banks has been definitely restricted.

The Agricultural Credits Act of 1923 imposed restrictions upon financing institutions rediscounting with the Intermediate Credit Banks which make them less attractive than other sources for seasonal loans and effectively discourage a permanent expansion of business on borrowed funds. Not until April 9, 1931 were local discounting institutions allowed a spread of 3 per cent above the rate charged customers on paper rediscounted with the Intermediate Credit Banks.⁴

Not only did these narrow margins severely restrict the gross income from rediscounted paper but they tended to force customers' rates below the prevailing level of rates. As might be expected, commercial banks objected to these price-fixing devices which threatened the local rate structure. Interest rates in the important

⁴ See p. 89 for operating margins prior to this date.

agricultural and livestock areas are sufficiently high to be materially affected by arbitrary limits on the spread between discount rates and customers' rates.

A comparison of the discount rates of the Columbia, Houston, and St. Paul Intermediate Credit Banks with the rates charged by member banks on customers' paper which they rediscount with the Reserve Banks shows a larger spread than the Farm Loan Board authorizes financing institutions to retain if they rediscount with the Intermediate Credit Banks. The spread between them ranges from 2.2 to 3.95 per cent in the Southeastern states; from 3.3 to 4.85 per cent in the Southwestern states, and from 2.7 to 4.2 in the North Central states.⁵

Inasmuch as the customers' rates used in this calculation are averages for all paper rediscounted they are not entirely representative of charges on agricultural paper, which frequently carries a higher rate than commercial loans. But even on the basis of these figures customers' rates in the Southeast exceeded the discount rate at the Columbia Bank by more than 2 per cent, which was the operating spread allowed financing institutions on crop production and general agricultural loans prior to April 1931. In the Houston and St. Paul Districts, where livestock loans predominate, the discount rate is ordinarily 3 or 4 per cent below the average rate on customers' paper. Obviously if the banks are limited to an operating spread of 2.5 or even the 3 per cent which is now permissible on paper rediscounted with the Intermedi-

⁵ The figures for customers' rates were obtained from the *Annual Report of the Federal Reserve Board*, 1928, p. 102. These rates are the average rates charged by member banks on customers' paper rediscounted with the Federal Reserve Banks during 1921-28. Only banks in towns having a population under 15,000 are included inasmuch as their paper is more representative of agricultural areas.

ate Credit Banks, the maximum rate they can charge customers may be less than the prevailing market rate. Commercial banks are reluctant to weaken the local rate structure; hence the attempts of Congress to force banks to accommodate their customers at lower rates, if they make use of government discounting facilities, has had no appreciable effect upon the commercial bank rates but has discouraged discounts.

Federal Intermediate Credit Banks were intended permanently to supplement the regular banking resources of agricultural communities as well as to furnish seasonal accommodations. In areas where bank capital and customers' deposits do not provide sufficient loan facilities, commercial banks can in effect make permanent additions to their lending capacity by rediscounting with the Intermediate Credit Banks. Presumably these capital deficit areas are served by small banks with little capital and a small volume of deposits. Under our system of unit banking, and with the large number of small rural banks remaining outside the Reserve system, these communities are without ready access to surplus deposit funds of other areas. Moreover, Reserve Bank credit and loans from correspondent banks are for temporary or seasonal emergencies and not for purposes of permanent expansion. Since the Intermediate Credit Banks draw upon investment funds of the central money markets they quite properly can supplement bank capital in those areas where additional credit can be used profitably and safely in financing agriculture. It was expected that commercial banks serving these areas would avail themselves of this opportunity to serve their localities more effectively.

As a matter of fact, the Intermediate Credit Banks

have not increased permanently the credit resources of rural banks. Country banks have shown little disposition to expand their normal business by rediscounting regularly with the Intermediate Credit Banks. In addition to their traditional dislike of continuous borrowing, limitations on the amount of indebtedness and the narrow operating margin discourage this method of expanding the banking resources of capital deficit areas. Even if a bank is willing to expand its normal volume of business by using borrowed funds when the gross income on the increased business is limited to 3 per cent, the limits of such expansion are closely set.

Rediscount liabilities of commercial banks may not exceed twice their capital and surplus. In theory, a bank of \$30,000 capital and surplus could rediscount to a maximum of \$60,000.⁶ If its loans and discounts are normally five times its capital and surplus it can increase its loans to the community 40 per cent by rediscounting customers' notes with the Intermediate Credit Bank. In return for its liability as indorser and the expenses incurred in rediscounting \$60,000 of loans, the bank would now receive a gross annual income of \$1,800.

However, because of seasonal requirements or unexpected contingencies, it is seldom advisable to expand to this theoretical maximum. If \$30,000 of rediscount liabilities is estimated as a safe maximum, then the bank's gross annual income from this increased volume of business is only \$900. If a 5 to 1 ratio of loans and discounts to capital can be maintained, an increase of \$2,000 in bank capital would permit a loan expansion of \$10,000. At 8 per cent this new business would yield

⁶ If the state law establishes a lower limit for total liabilities, then the expansion is limited to that amount.

an annual gross income of \$800, which approximates the interest income obtained by rediscounting \$30,000 of loans. Probably an interest rate of 10 per cent is a more accurate estimate of interest charges in a community suffering from a permanent shortage of bank credit, which would mean a gross return of \$1,000. If the legitimate credit demands of the community regularly exceed the resources of local banks, and if these loans are to finance agricultural operations which are sufficiently profitable to justify a bank in assuming the liability of an indorser for the entire amount for a gross return of 3 per cent per annum, from the point of view of bank profits, expansion through increasing the capital investment is more attractive.⁷ Furthermore, bank profits in such a community, served by a commercial bank operating under the efficient management and with the sound credit judgment that is presupposed if a bank is regularly to obtain money at wholesale and retail it on the margins originally contemplated, would permit an expansion of business through a reinvestment of profits. In spite of the ideals of bank service, commercial banks are profit-making institutions quite unlikely to assume heavy contingent liabilities on additional business unless the margin of profit is attractive.⁸

⁷The authors do not attempt to estimate the increase in capital investment necessary to permit a loan expansion of a particular volume nor do they assume that a bank with a given ratio of loans and discounts to capital investment could, by merely increasing its capital, support a proportionate increase in loans. The growth and stability of deposits and the purpose and character of the loans would affect the legitimate expansion.

⁸It does not follow because any particular community affords an additional volume of profitable loans that commercial banks of the area can safely increase the proportion of local agricultural loans in their portfolio. This is true even though such paper may be readily rediscounted with an outside agency unless it can be assumed that the contingent liability of the bank is a nominal liability and that the

What effect the recent increase in operating margins to 3 per cent will have on the activity of commercial banks in using the facilities of the Intermediate Credit Banks remains to be seen. In making its announcement of the increase the Farm Loan Board commented on the fact that commercial banks were not disposed to avail themselves of the discount privilege under existing conditions and that the change was made in the hope of increasing their use of the system. Since the Reserve Banks and city correspondents, which are alternative sources of credit, do not undertake to dictate the price at which country banks shall serve their customers, the Intermediate Credit Banks can not expect to compete with them for seasonal requirements if legal restrictions on operating margins exert a downward pressure on interest rates.

The situation is somewhat different in the case of a permanent expansion of business. Interest rates on local loans are ordinarily well above the rates on high-grade securities, bonds, bankers' balances, or call money which make up the secondary reserves of country banks. If a larger portion of earning assets can be invested safely in local enterprises because of the opportunity to rediscount with the Intermediate Credit Banks, banks in capital deficit areas may, if the margins allowed are commensurate with the risks assumed, undertake to supply a larger proportion of the credit requirements of the locality.

Thus far, however, country banks have declined to act as direct guarantors of farmers' notes to any appreciable extent. Whether they will change their policy now

loans will be renewed until paid by the maker. The necessity to secure a geographical distribution of risks as well as a variety in character of loans places a definite limit to the proportion of a bank's resources which can be invested locally.

that returns are more generous is conjectural. Meanwhile an extensive system of agricultural credit corporations and livestock loan companies has been created to serve as connecting links between the Intermediate Credit Banks and local borrowers. Their role in making Intermediate Credit Bank funds accessible to the various branches of our agricultural industry will be considered in the following two chapters.

CHAPTER VI

AGRICULTURAL CREDIT CORPORATIONS FOR THE LIVESTOCK INDUSTRY

During the legislative debates on the Agricultural Credits Act, spokesmen for the livestock industry stressed the desirability of placing Federal Reserve funds more freely at the farmer's disposal rather than creating additional credit institutions financed with government funds.¹ Officials of the War Finance Corporation, on the other hand, urged the need of a special type of credit institution for lending on livestock. Many of the cattle loan companies which had been established by private initiative to meet this need had been forced into bankruptcy by the heavy losses experienced by cattlemen after 1921. To remedy this breakdown of the livestock financing machinery, and to furnish a type of credit institution better adapted to the needs of the industry, the Agricultural Credits Act provided for the formation of National Agricultural Credit Corporations.² In addition to these federally chartered corporations, agricultural credit corporations and livestock loan companies organized under state laws were privileged to rediscount livestock paper with the Intermediate Credit Banks. It was hoped that these additional credit facilities, combined with efforts to improve the security underlying livestock loans, would enable livestock paper to command a credit standing in the money markets of the country equal to that enjoyed by other classes of paper.

¹ See Chap. III.

² See pp. 93-103.

Private enterprise has made little headway in establishing National Agricultural Credit Corporations. In fact only one corporation, the Pacific National Agricultural Credit Corporation, has been organized under federal charter for the purpose of financing livestock producers. Instead most of the livestock loans originate with state incorporated livestock credit corporations, which are subject to fewer legal restrictions.³ Therefore a study of livestock financing through the Intermediate Credit system is largely an examination of the success of state chartered loan companies. Control and supervision of their business practices in so far as they may affect their rediscount operations are largely the responsibility of the Intermediate Credit Banks, subject to the approval of the Federal Farm Loan Board.⁴

I. LIVESTOCK CREDIT CORPORATIONS, 1923-25

Livestock credit corporations have been created for two distinct and somewhat contradictory purposes. The view of commercial banks and other credit institutions having delinquent or uncollectable paper was that livestock credit corporations were convenient mediums through which frozen assets could be transferred to the Intermediate Credit Banks and their own funds re-

³ See Chap. IV for a comparison of the provisions governing state and federally incorporated credit corporations.

All livestock credit corporations rediscounting paper with the Intermediate Credit Banks must conform to practices approved by them and by the Farm Loan Board, regardless of their charter privileges. This administrative supervision serves the same purpose as more exacting legal provisions or the control exercised by the Comptroller of the Currency over National Agricultural Credit Corporations.

⁴ The designations "agricultural credit corporation" and "livestock loan company" are used interchangeably for local discount corporations which finance livestock producers. To avoid confusion the authors use the expression "livestock credit corporation" throughout to indicate state incorporated loan companies financing livestock paper exclusively.

leased. The other view was that these corporations were specialized financing institutions particularly well adapted to the needs of livestock producers and having access to outside funds through rediscounting with the Intermediate Credit Banks provided they avoided the errors of the old cattle loan companies. Clearly they could not serve both these purposes at once.

During the period 1923-25 a majority of the credit corporations in livestock districts were created for the purpose of relieving financing institutions of their past due livestock loans. Although the War Finance Corporation had advanced large sums to commercial banks and cattle loan companies for this purpose—in fact, had continued to make such advances until November 1923—more assistance was needed. Many livestock leaders and their political representatives expected the Intermediate Credit Banks to take over this emergency relief work. A few banks and loan companies rediscounted paper directly, but a majority, because of their own precarious financial condition, preferred to transfer these loans through the medium of affiliated credit corporations. Others aided in setting up independent livestock credit corporations to relieve them of the responsibility of financing former customers. As might be expected, credit corporations which hoped to transfer the less desirable assets from the portfolios of distressed banks, or which were organized to meet emergency situations, had a minimum capital investment, were short-lived, and at no time succeeded in borrowing substantial amounts.⁵ The Farm Loan Board, in behalf of the In-

⁵ In the Wichita District 18 livestock credit corporations had opened and closed their accounts with the Intermediate Credit Bank before the close of 1925. These corporations, at the peak of their borrowing, averaged less than \$40,000 of rediscounts.

intermediate Credit Banks, declined the role of emergency banking institutions and insisted that all extensions of credit must conform to strict banking practices. The promptness with which livestock credit corporations were organized and the excessive mortality among the early accounts opened with the Intermediate Credit Banks are apparent from the accompanying table, which covers all

MORTALITY OF ACCOUNTS OF LIVESTOCK CREDIT CORPORATIONS WITH INTERMEDIATE CREDIT BANKS, 1923-29*

District	Accounts Opened, 1923-25		Accounts Opened, 1926-29		All Accounts Opened to Dec. 31, 1929	
	Total	Active Dec. 31, 1929	Total	Active Dec. 31, 1929	Number	Active Dec. 31, 1929
St. Paul.....	106	35	31	25	137	60
Omaha.....	56	15	13	8	69	23
Wichita.....	42	2	1	1	43	3
Houston.....	18	8	8	6	26	14
Spokane.....	15	6	17	12	32	18
Berkeley.....	6	5	3	3	9	8
Total.....	243	71	73	55	316	126

* The dates when accounts were opened and liquidated were obtained directly from the Intermediate Credit Banks. Agricultural credit corporations which are concerned primarily with crop production or general agricultural loans have been omitted from this table.

credit corporations organized in the six major livestock districts.

Before the close of 1925, 243 accounts had been opened for the purpose of refinancing livestock paper, but by December 31, 1929 less than 30 per cent of them remained active. Only 73 such accounts were opened during the following four years, but 75 per cent of the corporations maintained their discount relationship at

the close of 1929. Aside from the fact that the accounts had been in existence for a shorter time, this greater stability is to be expected for two reasons: they were based upon a more accurate notion of the credit standards of the Intermediate Credit Banks; and for the most part they were utilized to advance funds for current operations rather than to relieve affiliated organizations of past due paper.

An analysis of the reasons for closing the accounts opened during 1923-25 clearly reveals their relief function. Although a single explanation for closing an account seldom states the situation fully, it is fair to say that financial difficulties of affiliated banks or cattle loan companies account for a major portion of the casualties.⁶ A large number of the accounts were closed because of mutual dissatisfaction with the relationship, but the Intermediate Credit Banks usually took the initiative. Banks that had organized livestock credit corporations because their own affairs were in bad shape resented the investigations of the Intermediate Credit Bank examiners. Discounting institutions complained of the delays in obtaining proceeds and the vexatious details in the procedure for securing loans. The requirements complained of, which were indiscriminately labeled as "too much red tape," were often necessitated by the unsatisfactory financial condition of discounting institutions and reluctance on the part of their officials to reveal their exact status. The record of failures among the commercial banks which organized these first livestock credit corporations fully justifies the strict requirements and many precautions of the Intermediate Credit Banks.

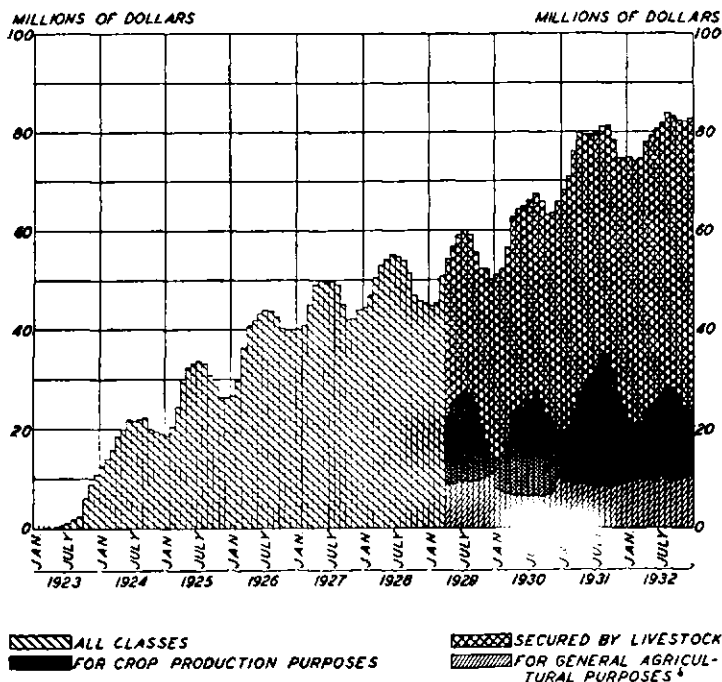
⁶ These conclusions are based upon a detailed analysis of all accounts closed in the Omaha District.

By degrees undesirable and unprofitable accounts were closed out and small financially unreliable corporations were merged with stronger associations operating in the same territory. Improved conditions in the livestock industry and in the commercial banking situation led to the liquidation of other accounts. Meanwhile, any substantial growth in livestock discounts was prevented because of the uncertain financial responsibility of many credit corporations, their temporary character, and their preoccupation with past due accounts rather than with loans for current operations. Their gradual disappearance cleared the way for livestock credit corporations designed to serve as permanent financing institutions.

II. LIVESTOCK CREDIT CORPORATIONS AS PERMANENT FINANCING INSTITUTIONS

After 1925 livestock credit corporations with larger capital resources gradually replaced those with a minimum capital and negligible lines of credit. As a result, the dollar volume of discounts secured by livestock paper has increased rapidly, and the livestock industry is claiming an increasing proportion of the total discounts of the Intermediate Credit Banks. The table on page 129, which gives the dollar volume of discounts outstanding at the close of each year, indicates the rapid growth in business after 1925 and shows for the years 1929-32 the distribution of loans between the several branches of the livestock industry. But year-end figures cannot be used to show the relative importance of livestock loans, crop production loans, and general agricultural paper, because production loans are liquidated immediately after harvest while livestock loans are often at their peak at the close of the year. However, the chart on page 128, showing discounts outstanding at the close of each

DISCOUNTS FOR AND LOANS TO FINANCING INSTITUTIONS
 Total Outstanding at End of Each Month, May 1923-
 December 1932, Classified According to Purposes,
 April 1929-December 1932^a



^a Since May 19, 1932 the Intermediate Credit Banks are permitted to make loans to financing institutions on the security of their own notes payable as well as to discount individual producers' notes.

^b The distinction between general agricultural paper and loans for crop production purposes is not very sharply drawn because of lack of uniformity on the part of the banks in reporting the purposes for which loans are made. Consequently the annual reports of the Federal Farm Loan Board now carry only two classifications of loans—those secured by livestock collateral and those secured by general agricultural collateral.

month, indicates that during the past three years livestock loans have been absorbing an increasing amount of all discounts until they now make up more than two-thirds of the total.

Livestock discounts previous to 1926 at no time reached 15 million dollars, which is less than three or four large cattle loan companies handled before the depression of 1921. Cattle loans, including dairy cattle, in 1932 were 60 per cent of the total. But the most rapid increase has been in sheep loans. Although livestock loans have more than trebled since 1925, only 59

DISCOUNTS SECURED BY LIVESTOCK COLLATERAL, 1923-32^a
(Amounts outstanding December 31, in thousands of dollars)

Year	Dairy Cattle ^b	Cattle	Sheep and Goats ^b	Other Livestock	Total
1923.....	.....	3,197	.....	2,112	5,309
1924.....	.....	7,767	.....	3,975	11,651
1925.....	.....	8,204	.....	6,561	14,765
1926.....	.....	14,347	.....	10,184	24,531
1927.....	.....	17,932	.....	15,574	33,506
1928.....	.....	20,541	.....	15,663	36,204
1929.....	1,643	22,467	10,954	249	35,312
1930.....	2,714	28,195	15,014	334	46,257
1931.....	2,650	28,794	19,030	477	50,951
1932.....	2,232	35,715	20,307	879	59,133

^a Data are from *Annual Reports of the Federal Farm Loan Board*. Loans to financing institutions secured by their own notes payable are included with discounts.

^b Prior to 1929 all livestock discounts were classified under "cattle" and "other livestock."

million dollars of discounts were outstanding in December 1932, which is a negligible amount in comparison with the total credit requirements of the industry, which are estimated to amount to about a billion dollars annually.⁷

Why are Intermediate Credit Bank funds used so

⁷ The rapid increase in livestock discounts from 1930 to 1932 is in large part accounted for by the operations of the National Feeder and Finance Corporation, a subsidiary of the National Livestock Marketing Association set up by the Federal Farm Board. See p. 139.

LOAN RATIOS OF LIVESTOCK CREDIT CORPORATIONS*
I. Corporations Classified According to Capital and Surplus

Classification	Number of Corporations	Capital and Surplus (In thousands)	Discounts Outstanding ^b (In thousands)	Loan Ratio
Less than \$25,000...	15	\$ 193.3	\$1,153.6	6.0:1
25,000- 99,000...	22	954.8	6,584.7	6.9:1
100,000-249,000...	11	1,858.5	9,433.7	5.1:1
250,000-499,000...	4	1,211.6	5,473.3	4.5:1
500,000-999,000...	3	1,775.0	6,765.6	3.8:1
1,000,000 or more...	3	3,171.1	2,572.3	0.8:1
Total.....	58	\$9,164.3	\$31,983.2	3.5:1

II. Corporations Classified According to Districts

Omaha.....	22	\$2,358.6	\$ 6,978.3	3.0:1 ^c
Wichita.....	9	332.0	2,337.3	7.0:1
Houston.....	19	2,747.0	13,863.2	5.0:1
Berkeley.....	8	3,726.7	8,804.4	2.4:1
Total.....	58	\$9,164.3	\$31,983.2	3.5:1

* All data were obtained from the Intermediate Credit Banks.

^b The figures for discounts outstanding are not of the same date for each district—Dec. 31, 1930 for the Omaha and Houston Districts; Dec. 31, 1929 for Berkeley; and Apr. 30, 1931 for Wichita. However, this discrepancy does not affect the comparability of data for our purposes, since there is no general liquidation date for livestock loans. Corporations in process of liquidation have been omitted since their loan expansion would not be characteristic of a going concern. One or two corporations recently organized have not reached their maximum expansion, but they are small and do not materially affect the general picture.

^c If three corporations were omitted from this computation—one, with capital and surplus of more than a million dollars but with only one loan under discount, and two which are semi-private loan companies making loans only to members of the firm which organized the loan company—the average loan expansion for the Omaha District would be 7.5:1, which is a more accurate statement for the district as a whole.

sparingly in financing livestock? Does the scarcity of capital for local loan companies account for the meager volume of discounts? Do existing livestock credit cor-

porations utilize the discount facilities to the maximum their capital investment permits and, if not, what is the explanation of their failure to borrow freely? An examination of the loan ratios for livestock credit corporations in the Omaha, Wichita, Houston, and Berkeley Districts affords a basis for answering these questions (see the table on page 130). Since 70 per cent of all livestock loans originate in these four districts the loan expansion of these livestock credit corporations can be accepted as representative for all corporations rediscounting livestock paper.

Livestock credit corporations quite consistently fail to pyramid their capital investment to the theoretical legal maximum.⁸ Although the capital and surplus of the corporations included in the table on page 130 exceed 9 million dollars, this investment supports only 32 millions of discounts—an average loan expansion of three and one-half times invested capital. Average loan ratios are of course somewhat misleading. Thirty odd corporations, which together control only one-third of the total capital resources, originate 70 per cent of all livestock discounts. These corporations have a loan expansion of seven times their capital and surplus. If all livestock credit corporations maintained a similar loan ratio the present capital investment in these four districts would support loans amounting to 52 millions—an increase of 62 per cent over their present volume. In-

⁸ Although a loan ratio of ten times the paid-in and unimpaired capital and surplus is permitted by law, the amount of paper which an Intermediate Credit Bank will discount for a credit corporation depends upon "the character of the paper offered, the security therefor, the management of the corporation, the manner in which its capital is invested, and the amount thereof pledged with the bank as additional security, the ratio varying from three to eight times the paid-in and unimpaired capital of the discounting institution." See *Federal Intermediate Credit Banks Circular No. 2*, January 1932.

stead, ten corporations, each with capital and surplus exceeding \$250,000, have an average loan expansion of only two and one-half times their capital.

These more modest loan ratios of livestock credit corporations with an invested capital of a quarter of a million or more arise from several causes. Among these corporations are casual discounters which make no effort to borrow as freely as their capital resources permit. This group is made up of corporations that are ostensibly livestock loan companies but whose major business is real estate loans or the operation of ranch properties. They qualify for discount privileges in order to accommodate customers or members of their operating firm but do not loan to livestock producers in general. Naturally their borrowings are determined by the credit requirements of these selected customers and not by their own capital resources.

Except in the cases of these semi-private loan companies that are only incidentally concerned with making livestock loans, we must look to the conditions under which livestock credit corporations operate for an explanation of their reluctance to pyramid their capital resources until they support a volume of discounts more nearly equal to the legal maximum. Their business affiliations not only affect the zeal with which they solicit new business which can be carried only through borrowing but also determine the source of their borrowings. And, second, legal restrictions and the regulations imposed by the Intermediate Credit Banks in order to maintain sound credit conditions tend to restrict discounts. A discussion of this last cause of moderate loan expansion will be postponed until the following chapter. At this point we shall examine the effect upon dis-

counting of the special interests and the financial connections of the groups under whose auspices livestock credit corporations function.

III. BUSINESS AFFILIATIONS OF LIVESTOCK CREDIT CORPORATIONS

Since the Agricultural Credits Act did not specifically charge any agency with responsibility for fostering local discount corporations, this function has devolved upon a variety of interests. Among the groups most active in setting up livestock credit corporations are commercial banks, co-operative livestock associations, and private business interests which range from large packing houses and livestock commission firms on terminal markets to individual business men who combine other activities, such as selling insurance or real estate, with the livestock loan business.

Commercial banks in livestock marketing centers and country banks in producing territories were the institutions nearest at hand to sponsor livestock credit corporations. But, as we have already seen, commercial banks in the beginning were too engrossed with the possibilities of using credit subsidiaries to unload frozen assets to study their possibilities as permanent credit institutions. Only the weakest banks in the livestock areas availed themselves of the new discount facilities. Even after livestock credit corporations were no longer regarded as liquidating agencies for financially embarrassed banks, the commercial banking system as a whole played a minor role in making Intermediate Credit Bank funds accessible for livestock producers.

Two notable exceptions to this generalization must be made: the work of the Pacific National Agricultural Credit Corporation, and the recent activities of branch

and group banking systems in organizing livestock units. The Pacific National Agricultural Credit Corporation was organized in July 1925 through the joint efforts of the Western Cattle Marketing Association and the commercial banks of Los Angeles and San Francisco. Approximately 80 per cent of the original capital was subscribed by commercial banks in these centers and the other 20 per cent by Western cattlemen and private investors. This corporation, which makes loans on livestock throughout California, Arizona, Nevada, Oregon, Utah, Idaho, New Mexico, and Texas, on September 29, 1931 had 2.8 million dollars rediscounted with the Intermediate Credit Bank.⁹ At this same date discounts of the Intermediate Credit Banks secured by livestock collateral amounted to 46.2 million dollars. That is, slightly more than 6 per cent of all the livestock paper discounted by the Intermediate Credit Banks originated with the Pacific National Agricultural Credit Corporation, which is closely affiliated with commercial banking interests.

A more recent development is the activities of branch and group banking systems in organizing livestock credit corporations. The Bankamerica Agricultural Credit Corporation—one of the largest livestock loan companies in the Berkeley District—is a wholly owned subsidiary of the Transamerica Corporation. This credit corporation was organized in March 1928 with a capital of 1 million dollars under the name Bankitaly Agricultural Credit Corporation, which was changed in

⁹ The Pacific National Agricultural Credit Corporation had loans outstanding in the amount of 3.1 million dollars on Sept. 29, 1931, but its capital and surplus of \$600,000 enable it to carry approximately half a million loans without rediscounting them. Figures are from *Report of the Comptroller of the Currency*, 1931, p. 163.

1930 to its present title. At the close of 1929 its discounts of more than two million dollars made up 23 per cent of all livestock discounts outstanding in the Berkeley District.¹⁰

Even more recently two group banking systems which operate throughout the North Central states have added livestock loan companies to their system of banks. The Northwest Bancorporation of Minneapolis organized the Northwest Livestock Loan Company, a security holding company, which controls through stock ownership two livestock loan companies—the Montana Livestock Loan Company, Helena, Montana, and the Cattle Feeders Loan Company, Omaha, Nebraska. Together these two operating corporations handle approximately 5 million dollars of livestock loans.¹¹

The First Bank Stock Corporation, a second group banking system with principal offices in Minneapolis and St. Paul, has also acquired a livestock loan company. In July 1931 it purchased a controlling interest in the Agricultural Credit Corporation of Minneapolis, which was organized in 1924 for the purpose of taking over livestock loans from distressed and closed banks. This business, however, proved unprofitable and the credit corporation soon confined its activities to making advances directly to livestock producers. Shortly before this corporation was absorbed in the First Bank Stock group system, it had nearly 2.5 million dollars of livestock loans outstanding in the six states of North and South

¹⁰ These figures refer to rediscounts with the Intermediate Credit Bank of Berkeley. The credit corporation of course may draw upon idle deposit funds of commercial banks which are subsidiaries of the Trans-america Corporation.

¹¹ A letter of Nov. 3, 1931 from Alex Highland, vice-president of the Northwest Livestock Loan Company, gives this estimate of the volume of loans.

Dakota, Minnesota, Montana, Michigan, and Wisconsin. Although it will continue to serve the same territory as before, its policy will be to devote most of its activities to the communities in which the First Bank Stock Corporation has purchased banking units.¹²

Livestock credit corporations which are owned outright by strong commercial banking systems, or closely affiliated with them, are comparatively independent of outside sources of credit. Although these credit affiliates rediscount with the Intermediate Credit Banks as the need arises, they are unlikely to pyramid their capital investment to the same extent as independent credit corporations. As units of a branch or group banking system they draw upon surplus deposit funds within their territories; they also have ready access to Reserve Bank credit for seasonal requirements, frequently at lower rates than the Intermediate Credit Bank discount rates. The Pacific National Agricultural Credit Corporation and the Bankamerica Agricultural Credit Corporation each had a loan expansion of approximately 2.6 to 1 on December 31, 1929, which is distinctly less than that maintained by corporations operated independently of commercial banks and far below the maximum permitted by law. Because their affiliations with commercial banks afford them alternative sources of credit, an increase in their volume of business does not necessarily result in a rapid increase of discounts with the Intermediate Credit Banks.¹³ In fact, if branch banking is legalized within

¹² A letter of Oct. 9, 1931 from the vice-president and general manager outlines the future policy of the loan company.

¹³ The following chapter will deal with the administrative and legal restrictions which discourage permanent expansion on borrowed funds, even if eligible loans are available and the capital investment does permit further rediscounting.

Federal Reserve districts or even within trade areas which are extensive enough to allow reasonable diversification of risks, it would seem that there might be less demand for the services of the Intermediate Credit Banks.

Livestock credit corporations are also organized by co-operative livestock commission firms, which find them valuable adjuncts to their regular marketing activities.¹⁴ It is a long-established practice of private commission houses to make advances to prospective shippers or to make loans on feeder stock purchased through them with a collateral agreement that all livestock securing these loans is to be marketed through them. In order to compete effectively with these commercial agencies, co-operative livestock associations were led inevitably into the cattle loan business. An officer of the Central Co-operative Association summarized the competitive situation concisely when he said:

The loans which are made by our opponents at the stock yards are made in such a way that a contract always brings these cattle, which the money is loaned on, back to their alleys to sell and they get their commissions.¹⁵

Naturally co-operative commission associations have adopted similar devices to expand their shipments and increase their earnings.¹⁶ The Producers livestock commission houses on the East St. Louis, Chicago, Pitts-

¹⁴ See Edwin G. Nourse and Joseph G. Knapp, *The Co-operative Marketing of Livestock*, pp. 169-75.

¹⁵ Statement by President Crandall, Central Co-operative Association, South St. Paul. Quoted in the *Co-operative Shipper*, March 1930.

¹⁶ It should be noted, however, that at least some of the spokesmen for the Livestock Marketing Association deprecate the placing of emphasis upon financing as a means of building up the earnings of terminal commission associations. They entertain a broader conception of this work as designed to place the livestock industry upon a sound economic basis by a more strict supervision of its financing.

burgh, Cincinnati, Cleveland, and Buffalo¹⁷ terminal markets jointly operated a livestock credit corporation until it was absorbed in the national credit system set up by the Federal Farm Board. The corporation was organized in April 1924 with headquarters at National Stock Yards, Illinois, with only the Chicago and East St. Louis houses participating at the beginning. At the time it was taken over as a regional unit of the National Feeder and Finance Corporation in 1930 it was advancing between half a million and a million dollars annually to feeders throughout the Corn Belt area. Likewise, the Farmers' Union commission houses of Omaha and South St. Joseph set up finance subsidiaries in November 1924 and July 1926 which were soon advancing several hundred thousand dollars annually to their members. The Central Co-operative Association of South St. Paul set up a livestock credit division in 1928. Whenever these credit subsidiaries make loans on livestock it is with the stipulation that the finished animals must be consigned to the affiliated commission firm for sale. Although livestock co-operatives thus far have confined their loans primarily to feeder stock there is no reason why breeding and stocker loans cannot be granted through co-operative channels.¹⁸

Originally the capital for these livestock finance subsidiaries was obtained from the co-operative livestock marketing associations, but more recently the Federal Farm Board has participated indirectly in providing

¹⁷ The Indianapolis Producers have done some financing but independent of the credit association in which the other Producer houses joined.

¹⁸ See Chap. XI for a discussion of pre-shearing advances made by the Pacific Wool Growers' Credit Corporation. These advances finance producing operations, but in the guise of marketing loans.

capital for credit corporations affiliated with the "national" marketing organization.¹⁹ The livestock co-operatives may provide capital from their accumulated reserves, which they supplement by loans from the association. If they need additional working capital they may sell preferred stock to their members and to outside investors if possible.

The Federal Farm Board, as a part of its program to organize the livestock industry on a national basis, has projected a comprehensive system of regional livestock credit corporations to finance livestock producers. The National Feeder and Finance Corporation, a subsidiary of the National Livestock Marketing Association, is a holding company for the regional credit corporations. It has an authorized capital stock of 5 million dollars, held exclusively by the marketing association. The latter borrowed from the Federal Farm Board to purchase this stock and the funds so obtained have been used by the Feeder and Finance Corporation in purchasing 80 per cent of the capital stock of the regional credit corporations which are set up in the several Intermediate Credit Bank districts for the purpose of advancing loans to livestock producers.²⁰ The savings of these local credit associations are expected to furnish a revenue to the Feeder and Finance Corporation which will in

¹⁹ The Reconstruction Finance Corporation has announced the formation of twelve regional agricultural credit corporations. The 3 million dollar minimum capital for each is supplied by the government. See Chap. XV for further discussion of these corporations.

²⁰ At present six regional livestock credit corporations are in existence: National Livestock Credit Corporation of St. Louis, Chicago, Ill.; Tri-State Credit Corporation of California, San Francisco, Calif.; Wasatch Livestock and Loan Company, Salt Lake City, Utah; National Finance Credit Corporation, Fort Worth, Tex.; Intermountain Livestock Credit Corporation, Denver, Colo.; and National Livestock Credit Corporation, Oklahoma City, Okla.

turn be passed on to the National Livestock Marketing Association and enable it to repay the Farm Board loan. The marketing association and its subsidiary finance corporation will then be free to decide their future policy with reference to restriction of stock control in the regionals. It would seem likely, however, that the gains from having a national system with central supervision will dictate the continuance of this stock control.

The object of these credit facilities is of course to strengthen the co-operative marketing of livestock. But to what extent loans to producers do actually increase the volume of animals consigned to co-operatives, and hence how vigorously livestock co-operatives will develop their loan services, is difficult to measure. All livestock financed through credit subsidiaries must be sold co-operatively if sent to markets where co-operative facilities are available, but whether advances to producers are responsible for business that otherwise would be lost to the co-operative is somewhat conjectural. However, the livestock marketing program of the Farm Board is based upon the assumption that facilities for extending production and marketing credit will enable co-operatives more quickly to achieve a dominant position in the industry. Consequently, since credit corporations sponsored by co-operatives seldom have extensive lines of commercial credit, it is to be expected that this growth in co-operative marketing of livestock will be accompanied by a special effort to take over more of the livestock financing and will result in a marked increase in the volume of discounts with the Intermediate Credit Banks. Moreover, the limited amount of working capital that can be devoted to credit affiliates makes it imperative for them to pyramid their investment to a

high ratio if they are to be in a position to accommodate any considerable number of their members. In practice they select the safest and most desirable of the applications received and extend credit to only one out of 10, 15, or even 20 of those who seek accommodation.

Co-operative livestock marketing associations can operate livestock credit corporations advantageously, for many of the costs of operation, such as credit investigations and appraising collateral, can be handled with little additional expense. Loan applications can be prepared by officers of the marketing association; inspection at the range or feed-lot, if necessary, can be made by the co-operative's field men at a minimum of expense; and sometimes a more generous line of credit can be secured if the co-operative association indorses its members' notes.²¹ By sharing operating costs and risks of loss in this fashion, a livestock credit corporation soliciting business throughout the territory served by a co-operative association is able to develop a volume of business at a more reasonable cost than can an independent loan company or even a commercial bank which is not specially equipped to handle livestock loans.

Private commission firms and packing houses have the same privilege of establishing livestock credit corporations to discount with the Intermediate Credit Banks as do co-operative livestock associations. A limited number have taken advantage of this opportunity; but they can usually be classed as casual discounters because the exacting credit requirements of the Intermediate Credit Banks,²² together with the limitation upon the interest

²¹ The Federal Farm Board has discountenanced this practice on the part of livestock credit corporations affiliated with the National Livestock Marketing Association.

²² See Chap. VII.

rates which can be charged, discourage extensive rediscounting so long as regular lines of commercial credit suffice. In times of credit strain, when commercial banks curtail their livestock loans, these corporations may turn to the Intermediate Credit Banks for accommodation; but in normal times loan companies sponsored by private business interests are inclined to rediscount sparingly.

It may be worth while at this point to recall the proviso in the Agricultural Credits Act which forbids National Agricultural Credit Corporations to engage in buying or selling livestock on their own account. This separation of merchandising functions from the extension of credit was designed to prevent loans made in the interest of trading profit rather than on a sound credit basis. Apparently this combination of functions is not regarded with suspicion by the Intermediate Credit Banks if the sponsoring concern is a co-operative association, but the manager of at least one Intermediate Credit Bank is inclined to look with little favor upon loan companies organized by private commission houses. Since the avowed purpose of the loan service, whether supplied by co-operatives or private marketing agencies, is to strengthen a livestock merchandising program, there is reason to ask whether this objective is entirely consistent with conservative loan policies. At least those responsible for the provisions of the National Agricultural Credit Corporations felt it advisable to remove all temptation to relax credit standards by forbidding the integration of buying and selling with the making of loans.

This diffusion of responsibility for the organization and control of livestock credit corporations and the objectives which prompt various groups to engage in live-

stock financing suggest the difficulties of maintaining high credit standards and eliminating doubtful risks. The responsibility for evolving and enforcing credit policies which will remove the danger of an unwise expansion of loans or the infiltration of poorly secured paper into our rural credit system must rest finally with the Intermediate Credit Banks themselves, since the local discount groups have shown themselves incapable of exercising a uniformly dependable degree of control. These credit policies and their effect upon the development of our agricultural discount facilities will be discussed in some detail in the following chapter.

CHAPTER VII

ADMINISTRATION OF LIVESTOCK LOANS

The administrative policies of the Intermediate Credit Banks have been directed toward placing the livestock industry on a sound basis by improving its methods of financing. But before we can fully appreciate the restrictions which are imposed upon livestock credit corporations which rediscount with the Intermediate Credit Banks and judge the efficacy of the loan policies of these banks and the wisdom of the legislative provisions under which they operate, it is necessary to comprehend the outstanding defects in the old methods of livestock financing.

I. WEAKNESSES OF EARLY LIVESTOCK CREDIT PRACTICES

Really efficient institutions for extending credit to livestock producers, particularly to the range cattle industry, have never been devised. Some cattle and sheep men have had too much credit extended to them, others have suffered from insufficient credit, and practically all, whenever there was a little tightening of the money market, have had to pay a higher rate of interest than good security would warrant. Inadequate state laws, careless practices on the part of the loan companies, and the failure of the ranchmen to have a sufficient equity in their business and to co-operate with local institutions in order to safeguard their loans are all responsible for these conditions.

State laws in regard to livestock financing have been very defective. Livestock loan companies are incorporated under the general corporation laws of the various

states and do not come under the control of state banking departments. They are not compelled to keep any reserves against outstanding liabilities, and no restrictions are made as to the ratio of their liabilities to capital investment. An expansion of loans to the amount of 20 to 25 times their capital was no infrequent occurrence during the war. Such expansion of course rendered the livestock loan company's indorsement of its paper practically worthless.

Before the 1920-25 depression in the cattle industry it was commonly supposed that the original lender on cattle paper was the one who assumed the risk and that the purchasing bank or investor was making a safe and liquid investment.¹ Such, however, has not proved to be the case. In many instances when the cattle loans were called, the value of the security was not sufficient to liquidate them; and when the bank attempted to collect from the cattle loan company which had indorsed the paper, it found the company insolvent. Under these conditions the bank that purchased the paper suffered a loss.

In practice many of the old cattle loan companies were merely loaning agents that furnished the connecting link between cattlemen who wished to borrow and distant banks which were willing to lend on cattle paper. They partook of the nature of both note brokers and local lending agents. It is true that they indorsed the cattle paper which they handled; but, in view of the fact that there was no restriction or supervision over their lending operations, their indorsements were often of little value. If the livestock industry is to attract capital upon terms as favorable as those enjoyed by other industries,

¹ Forrest Larmer, "The Cattle Loan Company," *Journal of Political Economy*, 1918, Vol. XXVI, p. 825.

its paper must be put in such shape that there will be no doubt as to the soundness of the security offered. This can never be done without the aid of responsible local credit institutions whose indorsement can be relied upon in case an individual loan should prove worthless.

The absence of legal restrictions permitted careless loan practices on the part of many cattle loan companies. During the war, prices for cattle were high and constantly going higher, and the cattlemen were anxious to enlarge their herds as much as possible. Instead of exerting a conservative influence, the banks and the cattle loan companies were so carried away by the desire to increase production that they encouraged unwise borrowing. The whole period of approximately five years was a time of frenzied finance in this industry. Inspections of collateral were rather generally careless and sometimes outright dishonest. In the easy-going spirit of the times, loan companies left things largely in the hands of the borrower and did not bestir themselves to make as frequent contacts with him as later experience has demonstrated to be necessary. Particularly during the war, livestock loan companies extended credit on the flimsiest of security. Such loaning methods of course invited disaster to cattlemen, loan companies, and distant banks that bought the cattle paper.

A third weakness arose out of the fact that cattlemen did not own a sufficient equity in their business. All too often ranchmen expanded their herds on borrowed money to such an extent that they were operating on 90 per cent credit. Such a small equity by the owner in his business means that whenever a price drop occurs the margin of safety is wiped out and losses to creditors are inevitable. This is exactly what took place during 1920.

Within the space of five months after September 1, 1920 the average price at Chicago for mature steers fell from \$15.00 a hundredweight to \$8.00. Such a great drop in prices would severely shake confidence in a conservatively managed business. In an industry which had expanded as rapidly and on as much borrowed capital as had the range cattle industry in the preceding years, it almost precipitated a panic. Bankers became worried and tried to call their loans, with the result that the machinery for financing the industry broke down.

If the livestock industry is to be put on a sound basis these defects in methods of financing must be eliminated. The business practices of livestock credit corporations that rediscount with the Intermediate Credit Banks must conform to distinctly higher standards than were required of the old cattle loan companies whose activities were almost wholly unsupervised.

II. BUSINESS PRACTICES OF LIVESTOCK CREDIT CORPORATIONS

Although the Agricultural Credits Act made detailed provisions for the governance of National Agricultural Credit Corporations, few restrictions were placed upon the state incorporated livestock loan companies.² Business practices which they must observe if they rediscount with the Intermediate Credit Banks vary somewhat according to the administrative policies of individual banks. Each bank has considerable latitude in establishing its own loan standards. But within the limits of the Agricultural Credits Act, and subject to the general supervision of the Federal Farm Loan Board, an Intermediate Credit Bank formulates loan policies for the guidance of

² See Chap. IV.

all livestock credit corporations rediscounting with it. In general these loan policies are designed to make certain (1) that livestock credit corporations are financially responsible for their indorsements; (2) that the underlying security of loans is ample to protect the advance at all times; and (3) that the credit standing and business practices of individual borrowers make them acceptable credit risks.

If the Intermediate Credit Banks are to be protected against losses the indorsement of discounting corporations must be wholly reliable. To insure such financial responsibility corporations must avoid an excessive pyramiding of loans. By restricting lines of credit the Intermediate Credit Banks keep the loan expansion of a majority of the discounting corporations well below the legal maximum of ten times their unimpaired capital and surplus. Moreover credit corporations with lines of credit six or seven times their capital and surplus ordinarily are required to invest 50 per cent or more of their capital in bonds or other readily marketable securities which they pledge with the Intermediate Credit Banks as additional collateral further to secure their rediscounts. The table on pages 150-51 shows (1) the relationship between bonds deposited as additional collateral and discounts outstanding and (2) the loan ratios for livestock credit corporations rediscounting with Intermediate Credit Banks—that is, the ratio of discounts outstanding to capital and surplus.

It is apparent from these data that the Intermediate Credit Banks follow a highly conservative policy in extending credit. Inasmuch as corporations with capital resources of less than \$100,000 can develop a profitable volume of business only if they borrow heavily, they

normally carry a larger proportion of their capital in the form of bonds than do corporations with larger capital investment. All the corporations covered by the table on pages 150-51 with loan ratios of more than 5 to 1 have less than \$250,000 capital and surplus and each maintains a bond reserve which varies from 4.8 per cent to 10.5 per cent of its rediscount liabilities.

Livestock credit corporations of course prefer to utilize their own capital in making loans at the prevailing interest rate instead of investing it in low yield securities to pledge as additional collateral. Since the deposit of reserves is not required by law, the Intermediate Credit Banks stipulate the proportion of capital that is to be pledged in the form of bonds; or they may allow the corporation to pledge notes receivable as additional collateral. This privilege of substituting notes receivable for bonds, however, is restricted to corporations with substantial resources whose assets are sufficiently liquid to protect the interests of the Intermediate Credit Banks. None of the corporations with capital and surplus of \$250,000 or more has a bond account equal to 4 per cent of its rediscounts, but the average loan ratio is only 2.5 to 1.

Each Intermediate Credit Bank determines its own policy in regard to the amount of additional collateral required and the form in which it is pledged. In the Omaha and Wichita Districts, where a majority of the corporations are small but have a loan expansion of seven to nine times their capital, the policy of requiring a bond reserve of from 5 to 10 per cent of rediscounts is consistently observed. In the Houston and Berkeley Districts, where 60 per cent of the loans originate with credit corporations having capital resources of \$250,000 or

ADDITIONAL COLLATERAL PLEDGED BY LIVESTOCK CREDIT CORPORATIONS FOR INTERMEDIATE CREDIT BANK DISCOUNTS*
(All dollar figures are in thousands)

I. Classified According to Capital and Surplus of Corporations

Classification	Number of Corporations	Capital and Surplus	Discounts Outstanding	Additional Collateral		Loan Ratio	Bond Reserves as Percentage of Discounts
				Bonds	Notes Receivable ^b		
Less than \$25.....	15	\$ 193.3	\$1,153.6	\$121.8	\$ 26.9	6.0:1	10.5
25- 99.....	22	954.8	6,584.7	460.3	100.0	6.9:1	7.0
100-249.....	11	1,858.5	9,433.7	453.7	111.0	5.1:1	4.8
250-499.....	4	1,211.6	5,473.3	125.0	100.0	4.5:1	2.3
500-999.....	3	1,775.0	6,765.6	220.5 ^c	—	3.8:1	3.3 ^d
1,000 or more.....	3	3,171.1	2,572.3	92.7	70.8	0.8:1	3.6
Total.....	58	\$9,164.3	\$31,983.2	\$1,474.0	\$408.7	3.5:1	4.6

II. Classified According to Districts

Omaha.....	22	\$2,358.6	\$ 6,978.3	\$583.3	\$ 26.9	3.0:1 ^e	8.3
Wichita.....	9	332.0	2,337.3	133.3	—	7.0:1	5.7
Houston.....	19	2,747.0	13,863.2	385.0	286.3	5.0:1	2.8
Berkeley.....	8	3,726.7	8,804.4	372.4	95.5	2.4:1	4.21
Total.....	58	\$9,164.3	\$31,983.2	\$1,474.0	\$408.7	3.5:1	4.6

III. Classified According to Loan Ratios

Less than 3.0:1	16	\$4,840.1	\$ 5,171.7	\$162.3	\$ 78.5	3.1
3.0:1-4.4:1	9	1,067.2	4,068.9	339.0	24.2	8.3
4.5:1-7.4:1	14	2,034.6	11,938.5	424.4	196.2	3.6
7.5 or more:1	19	1,222.4	10,804.1	548.3	110.0	5.1
Total	58	\$9,164.3	\$31,983.2	\$1,474.0	\$408.7	4.6

* These data are for Dec. 31, 1930 for the Omaha and Houston Districts; Dec. 31, 1929 for Berkeley District; and Apr. 30, 1931 for Wichita District. All data for Intermediate Credit Bank discounts were obtained directly from the Intermediate Credit Banks.

b There are two circumstances in which notes receivable are deposited as additional collateral: First, when well-financed corporations are allowed to use them in lieu of bonds; and second, when bonds pledged are sold to take up past due rediscounts and these uncollected notes receivable are retained as additional collateral.

c The Pacific National Agricultural Credit Corporation is required by law to maintain a 7.5 per cent reserve with the Federal Reserve Bank of its district. An allowance of this amount is added to the additional collateral bonds pledged, although the Intermediate Credit Banks do not hold this reserve.

d If it were not for the 7.5 per cent reserve of the Pacific National Agricultural Credit Corporation, the percentage of bond reserves for this class interval would be only 1.1 per cent of discounts outstanding.

e A few corporations having a large capital investment, but with only a few loans under rediscount, reduce the loan ratio in the Omaha District. The corporations which are responsible for three-fourths of all discounts maintain a loan ratio of 7:1 or above.

f The 7.5 per cent legal reserve for the Pacific National Agricultural Credit Corporation is included, which increases the average for the district.

more, bond reserves are lower and notes receivable are frequently accepted in lieu of bonds. One explanation of this more lenient policy is that it is necessary to meet the competition of commercial banks, which require less additional collateral. Apparently it is more than a coincidence that the most rapid rate of growth in livestock discounts occurs in those districts where the credit standards are more nearly comparable with those of commercial banks.⁸

In addition to these efforts to improve the credit practices of discount corporations individual credit risks are selected with considerable care. Livestock producers are required to submit up-to-date financial statements that amply justify the credit asked. Thus far rural banks have made slow progress in persuading livestock producers to prepare satisfactory financial statements. In fact, the practice is so much of an innovation that the manager of a large cattle loan company in the Middle West insists that he cannot place loans in certain counties of Iowa because livestock producers there consider the necessity of submitting a financial statement such as the Omaha Bank requires a reflection upon their credit status and ability as livestock men. In spite of this prejudice in some quarters a careful analysis of a signed financial statement of recent date is required for every advance from any Intermediate Credit Bank.

The Intermediate Credit Banks also satisfy them-

⁸ The higher level of commercial interest rates may explain the willingness of cattle loan companies in the Southwest to transfer their lines of credit to the Intermediate Credit Banks, but probably this shift would not have occurred if the latter's credit standards were appreciably above those of commercial banks.

The Houston and Spokane Intermediate Credit Banks, both of which had a rapid growth in discounts in 1932, called an additional 1 million dollars of capital because their liabilities were approaching the legal limit permitted by their capital investment.

selves that the underlying security for loans is ample to protect their interests at all times. Competent and thorough inspection with actual tally and classification of the livestock has been substituted for the perfunctory inspection all too common when loan companies were able to place their paper quite freely with city banks. Instead of advancing so much per head, inspectors appraise the collateral, taking into consideration the quality and age composition of the herd. An appraisal which recognizes quality differences in herds enables borrowers with superior stock to realize the full loan value of their assets and the loan company to avoid losses due to over-appraisal.⁴ A conservative appraisal of the livestock pledged combined with adequate margins to allow for shrinkage in values during the life of the loan protects the local discount corporation against any ordinary losses. A loan basis of two-thirds the market value of stocker herds is customary, although 75 or 80 per cent

⁴ A sample loan schedule, dated July 1930 and made up by the Intermediate Credit Bank of Omaha for the use of inspectors, reads as follows:

Cattle Loans

Cows and two-year heifers	\$30.00-\$32.50
One-year heifers	22.00- 25.00
One-year steers	30.00- 32.50
Spring calves	20.00- 22.50
Two-year steers and up (per pound) .....	.045- .0525

Sheep Loans

Ewe lambs	\$3.00
One- and two-year ewes	5.00
Three-year ewes	4.00
Four-year ewes	3.00
Five-year ewes	2.00
Bucks	5.00
Old ewes	1.00

These figures apply to breeding and stock loans. Current market quotations govern the loan value of feeder stock.

may be advanced if market values appear to be unwarrantedly low. Sheep loans and breeding herds require somewhat larger margins because of the heavier death losses. On dairy herds advances are ordinarily limited to 75 per cent of the market value of the cows and preferably do not exceed the beef value of the cattle. If a borrower is purchasing livestock to add to his herd he may borrow the full purchase price by giving a chattel mortgage on his entire herd if the proper margin of safety is maintained.

Frequent renewal of loans with a periodic check-up on collateral is another desirable practice the Intermediate Credit Banks have introduced. Otherwise, declining prices, death losses, or the increasing age of a herd during the life of the loan may endanger margins. Although the Agricultural Credits Act permits three-year maturities, in practice cattle loans mature within nine months or at most a year and sheep loans normally within six months. This policy does not impose an unreasonable burden upon livestock producers, for renewals are readily granted if the security remains adequate. On the other hand, the credit corporation is entitled to an early opportunity to call for additional security if margins become impaired.

The extent to which this policy of frequent renewals is carried can be judged by analyzing the discounts outstanding at the close of 1930 for one Intermediate Credit Bank. Discounts secured by livestock collateral exceeded 7 million dollars, of which only 47.8 per cent were new loans, 23.1 per cent were renewal loans, and 29.1 per cent were classified as renewal of renewals.⁵ This in no

⁵ These figures were obtained from the 1930 annual report of this bank to its board of directors.

sense reflects a lack of liquidity of its assets but only illustrates the policy of requiring shorter maturities and frequent re-appraisals of collateral in preference to loan maturities which coincide with the actual turnover period of livestock operations.

The Intermediate Credit Banks reserve the right to inspect all collateral and ordinarily accept reports of inspectors for local credit corporations only if such inspectors have been approved by them. If a livestock credit corporation does not have a sufficient volume of business to warrant a full-time inspector, the Intermediate Credit Bank may provide inspectors and allocate costs to the several corporations in proportion to their use of the service. Local credit corporations sometimes make their own arrangements for inspectors but always subject to approval by the discounting bank. In the Wichita District, for instance, the Intermediate Credit Bank reserves the right to make its own inspection and "in general, inspections are made with sufficient frequency to prevent the total of uninspected loans from exceeding the total of capital pledged as additional collateral."⁶ If more than one inspector is needed to take the tally a representative of the Intermediate Credit Bank may accompany the local inspector when the loan is originally made and thus avoid the expense of separate appraisals. But whether the appraisals are made independently or jointly, all inspections must be so conducted as to remove any uncertainties as to the adequacy of the collateral pledged.

As a protection against heavy losses on a few large loans which might seriously impair the corporation's

* Quoted from a letter written by the president of the Wichita Bank to one of the authors.

capital, a limitation has been placed on the size of individual advances which are eligible for discount by the Intermediate Credit Banks. In the absence of any legal stipulation as to size of loans for state incorporated loan companies, the Farm Loan Board has ruled that loans to any one producer may not exceed one-half of the unimpaired capital and surplus of the livestock credit corporation.⁷ This limit is in sharp contrast to loan practices of the old cattle loan companies. It was not at all uncommon for them to make single advances amounting to several times their capital resources.

Livestock producers are encouraged to amortize their loans whenever feasible. Dairy loans are usually made on an amortization basis. Although final liquidation of the loans is not expected before 18 or 24 months, dairymen are urged to apply a portion of their monthly receipts to the retirement of their loans.⁸ Barring disease, if loans are based upon the producing capacity of the herd, an amortization scheme assures full security and high liquidity at all times. Furthermore, dairymen are given some notion as to the profitableness of their operations. If current proceeds are insufficient to pay off the indebtedness within two years, the indications are that the loan basis may be too high or that the feeding and care of the herd may be at fault. In the latter case, the pro-

⁷ The fact that National Agricultural Credit Corporations are forbidden by law to loan more than 20 per cent of their unimpaired capital and surplus to any one borrower is evidence that Congress approved an even more strict limitation upon individual advances. There is reason to believe that loans equal to half of the capital investment may be the source of considerable embarrassment to the regional credit corporations which have been recently established unless unusual precautions are taken to safeguard these large advances.

⁸ One livestock loan company in Idaho stipulates that 5 per cent of the loan is to be paid each month, thus liquidating the note in 20 months.

ducer is forced to scrutinize his production methods in order to meet the credit standards imposed.⁹

The amortization principle could readily be applied to loans on breeding herds, but it has not been extensively adopted. Generally speaking, livestock credit corporations are quite willing to grant release of proceeds from sales so long as loans are adequately margined.¹⁰ Unless proceeds from the sale of young animals are applied to reducing the note, loan margins are likely to be impaired because of the increased age of the herd, but ordinarily the credit corporations do not insist upon a systematic retirement of indebtedness.

A serious source of loss to creditors under the former unrestricted system of livestock financing was the sale of mortgaged livestock without remitting the proceeds to the mortgagee. Maturity dates were observed rather than the legal claims of creditors to specific property. By condoning these practices livestock loan companies made the illegal sale of mortgaged property more easy and, even if there was no intention to defraud, loan companies often found their margin reduced to a dangerous level or entirely wiped out. Investors were rightly sus-

⁹ Efforts of the Intermediate Credit Bank are in general directed to the safeguarding of collateral rather than to the improvement of production methods. Loan companies originating the loans and commercial banks are making some progress in this direction. For instance, a committee of the California Bankers' Association has recommended a loan rating for dairy herds based upon the quality and performance of the herd. A cow producing 200 pounds of butter fat annually is given a loan rating equal to the beef value only. Cows producing 350 pounds a year are rated at \$150. Bankers are also urging the adoption of accounting systems which will enable producers to detect waste and permit bankers to extend credit upon a showing of income and production costs. See the *Oregon Farmer*, Jan. 16, 1930.

¹⁰ Kenneth D. Oliver (manager, Field Department of the Pacific National Agricultural Credit Corporation), "Easy Money and its Dangers," *The Producer*, March 1928.

picious of livestock paper indorsed by financing institutions that failed to protect their legal rights to collateral pledged to secure loans. The Intermediate Credit Banks insist upon a strict accounting for the proceeds from the sale of all mortgaged animals. If a livestock producer desires to use the proceeds from the sale of security he must obtain a formal release from the mortgagee. Since the collateral is reinspected at intervals, and since the Intermediate Credit Banks audit the books of discount corporations twice annually, there is less chance of failure to remit proceeds.

Whether the measures taken are directed toward obtaining well-selected credit risks, safeguarding the collateral pledged, or strengthening the indorsements of the discounting corporations, the Intermediate Credit Banks are concerned with preventing livestock producers from being accommodated unless their own credit standing and the business practices of the credit corporations handling their loans furnish ample protection to investors in Intermediate Credit Bank debentures. But in the light of the small volume of livestock loans discounted by the Intermediate Credit Banks, it becomes a pertinent question whether the efforts to protect investors and the desire to secure lower interest rates for borrowers have not imposed conditions upon livestock credit corporations using Intermediate Credit Bank facilities which make it difficult for them to compete with other institutions making livestock loans.

III. EFFECT OF LEGAL LIMITATION OF INTEREST RATES

The desire of Congress to provide the lowest possible rates to borrowers consistent with maximum safety for the investors in Intermediate Credit Bank debentures has resulted in considerable reluctance on the part of

private enterprise to develop livestock credit corporations to their greatest usefulness. Financially responsible credit corporations can borrow freely from the Intermediate Credit Banks, ordinarily at rates below those on interbank loans, but they are obligated to pass this advantage on to their customers in the form of lower interest charges. This legal limitation on customers' rates reduces the interest income of livestock credit corporations in comparison with that of cattle loan companies with whom they compete for business, since the latter may borrow from commercial banks without any restrictions on their rates to customers. Moreover, these cattle loan companies are not bound by the credit standards which livestock credit corporations rediscounting with the Intermediate Credit Banks must observe.

The activities of livestock credit corporations may be affected in three ways by this limitation of interest rates. (1) The corporations may borrow from commercial banks rather than from the Intermediate Credit Banks.¹¹ (2) They may be discouraged from expanding their loan operations by means of borrowing. (3) They may attempt to enlarge their gross operating margins by means of supplementary charges which they pass on to the borrowers.

Since customers' rates may not exceed discount rates by more than 3 per cent, opportunities for profit are restricted and the incentive for livestock credit corporations to expand their operations by borrowing is weakened. Furthermore, when discount rates are low, this limitation upon customers' rates on loans rediscounted with the Intermediate Credit Banks may force corporations to accommodate customers at less than the current

¹¹ See p. 136 for a discussion of this point.

interest rate. Obviously managers are less anxious to solicit additional business on terms which threaten to undermine the local rate structure. This tendency is reinforced since an increase in volume often necessitates accepting smaller, less profitable loans, or loans at a greater distance which involve extra cost to place and follow up. Moreover the corporations are unable to recoup any losses they may experience in developing this additional business at low rates because when discount rates are high, the competition of commercial banks may force them to sacrifice a portion of their operating margin in order to retain their best customers.

Whether the operating margin affords a fair return on the capital investment is not the point at issue. Other financing institutions with which livestock credit corporations compete are not bound to reduce rates to borrowers merely because they can borrow at advantageous rates. Consequently the efforts of Congress to reduce interest rates restrict the services of the Intermediate Credit Banks rather than insure livestock producers more favorable rates.

But livestock credit corporations are not entirely helpless in this matter of gross revenues, for the Farm Loan Board has ruled that loans are eligible for discount even though borrowers are required to reimburse the credit corporations for the actual inspection costs incurred in placing or renewing their loans. Just what these additional fees amount to cannot be estimated precisely, for inspection costs are not standardized between districts or even within a given district. One corporation making more than a million dollars of range loans annually in Nebraska found that in 1929 inspection charges ordinarily added less than one-quarter of 1 per cent to the cost of loans of less than \$10,000, while they comprised

less than one-tenth of 1 per cent of the face of loans of \$50,000 or more. In no case did they enhance the cost to borrowers by more than one-half of 1 per cent.¹²

A greater variety of charges occurs with the livestock credit corporations in the North Central states, which handle "barn-yard loans."¹³ Sometimes a fixed percentage of the face of the loan is charged for appraisal, but more frequently a flat fee is assessed which may range from \$7.50 to \$15.00 according to the size of the loan. If the management estimates costs generously it may collect an amount which not only covers all outlays for inspection but which contributes something to the general operating expenses. The Intermediate Credit Banks, however, make every effort to prevent charges in excess of actual outlays for inspection. In addition to the inspection costs, borrowers are usually required to reimburse the corporation for the expense of clearing titles and recording mortgages, and for miscellaneous costs which may be incurred in preparing loan papers.

Whether any given schedule of fees exceeds the actual costs incurred in placing the loan and gives the credit corporation some free income it is impossible to say. But unauthorized charges make the paper ineligible for discount by the Intermediate Credit Banks, and the competition of commercial banks and cattle loan companies tends to keep these supplementary costs in line with customary charges for similar services. If all legitimate

¹² It is suggested by Mr. C. A. Stewart of the National Feeder and Finance Corporation that these costs are too low to be accepted as representative costs of placing livestock loans. This criticism is probably valid since a credit affiliate of a livestock marketing association is obliged to accommodate as large a proportion of its members as it can without relaxing credit standards, which would certainly increase the costs of placing loans and supervising them.

¹³ The expression "barn-yard loans" refers to loans made to general farmers and secured by small lots of livestock, a few dairy cows, and possibly work animals and farm machinery.

costs are included, livestock credit corporations probably obtain from borrowers between one-quarter to one-half of 1 per cent in addition to their interest margins.¹⁴

Livestock credit corporations sometimes share the costs of doing business with the borrowers by requiring them to subscribe to capital stock upon which very low dividends, if any, are paid. Each producer is asked to purchase stock equal to 10 per cent or more of the face of his note. At the outset, strenuous objections were made to this practice but, if capital was not available on other terms, livestock producers without other sources of credit could do little but acquiesce.¹⁵ At present the compulsory purchase of common stock is confined almost entirely to the mixed farming areas of the North Central states, where so-called "barn-yard loans" predominate.¹⁶ Recently a few credit corporations in this area have is-

¹⁴ The charges of the Wichita Bank, which serves the range territory of Colorado, Kansas, New Mexico, and Oklahoma, indicate that one-half of 1 per cent is sufficient to cover inspection costs. The Wichita Bank "purchases all loans subject to subsequent inspection of the collateral pledged as security and deducts one-half of 1 per cent from the proceeds of rediscounts as a temporary fund to cover inspection expense. When actual inspections have been made and expenses can be determined, adjustments are made. This expense may properly be collected by the corporation from the makers of the notes." Presumably actual costs fall well within the amount withheld to reimburse the bank. Quoted from a memorandum issued by the Federal Reserve Bank of Wichita, May 27, 1931.

¹⁵ Stockmen characterized this practice as "a most pernicious administration of the funds . . . perfectly legitimate except that it was not right." *Proceedings of the 28th Annual Convention of the American National Livestock Association*, Albuquerque, New Mexico, Jan. 14-16, 1925.

¹⁶ In the Omaha District eight corporations in 1930 required borrowers to purchase stock. These corporations were responsible for 43 per cent of all discounts outstanding Dec. 31, 1930, although their capital investment is less than 10 per cent of the total of the district. At present the Omaha Bank does not look with favor upon the organization of new livestock credit corporations with the intention of requiring customers to purchase common stock as a condition precedent to securing a loan, and has announced that discount privileges will not be granted if the practice is not abandoned.

sued preferred stock to borrowers, on which they expect to pay dividends.¹⁷

A recent decision of the Supreme Court of North Dakota places serious difficulties in the way of raising capital through compulsory stock purchase plans. The court in this instance held that the guaranteed 6 per cent preferred stock which the borrower had purchased and pledged with the credit corporation as additional security for his loan could be surrendered when he retired his loan, and that its face value and interest should be applied as part payment of his indebtedness. The court ruled that inasmuch as the representations of the bank, which the court held was acting as the agent of the agricultural credit corporation in making the loan, led the borrower to believe that the stock would be cancelled at the time he retired his loan, the corporation must credit his note with its par value.¹⁸

Although it would be possible for credit corporations to protect themselves against this obligation to retire their stock when loans are paid, the court raised a further question in respect to the practice of requiring borrowers to purchase stock. It pointed out that, if any of the proceeds of a loan were used for the purchase of stock to supply the permanent capital of a private lending corporation, the loan was not for an agricultural purpose and consequently was not eligible for discount by the Intermediate Credit Banks. Because of the legal question involved; as well as the administrative difficulties of rais-

¹⁷ Three livestock credit corporations in the Omaha District have arranged to pay dividends on their preferred stock. Two pay 4 per cent at the time the stockholder pays or renews his loan. These dividends are not cumulative. The other has paid 5 per cent dividends on Jan. 1, 1929 and Jan. 1, 1930. These dividends are cumulative. Data were obtained from questionnaires sent to the managers of these corporations or from the reports of the Intermediate Credit Bank examiner.

¹⁸ *Agricultural Credit Corporation v. Heim*. *North Western Reporter*, Sept. 14, 1932, Vol. 243, p. 809.

ing capital from borrowers, it is unlikely that livestock credit corporations will continue to find that compulsory stock purchases offer a practical solution to the problem of obtaining operating capital. Furthermore, the establishment of regional agricultural credit corporations with capital supplied by the federal government has removed the necessity for these involuntary subscriptions to capital stock.¹⁹

Not only have local livestock credit corporations operated under various difficulties which have severely limited the volume of their rediscounts, but the Intermediate Credit Banks suffer from certain handicaps which make it more difficult for them to achieve a dominant position in livestock financing. The Intermediate Credit Banks are required to operate on a 1 per cent margin, which forces them to accommodate only livestock credit corporations which offer loans that entail no appreciable risks. Narrow as this legal margin is, their realized margin is less than 1 per cent, because discount rates and debenture rates cannot be synchronized perfectly.²⁰ A gross margin of less than 1 per cent makes it impossible for the Intermediate Credit Banks to assume risks that are entirely permissible for commercial banks operating on more generous margins.

This narrow operating margin creates a special difficulty since the Intermediate Credit Banks tend to obtain what, from the point of view of profitable returns, is an adverse selection of business. Livestock credit corporations which are organized because of serious disturbances in the local banking situation look to the In-

¹⁹ See Chap. XV.

²⁰ The average spread in 1930 for one bank which receives most of its income from livestock discounts was 0.93 per cent. In 1929, when open money market rates were rising rapidly, its spread was only 0.88 per cent.

intermediate Credit system as the sole outlet for their paper. The emergency conditions place a heavy responsibility upon the Intermediate Credit Banks to exercise particular vigilance in eliminating unsatisfactory credit risks which local managers may be prone to accept. The expense involved makes paper offered by this type of institution less attractive than loans offered by established institutions with experienced management and unquestioned financial responsibility.

Moreover, some of the most profitable customers of the Intermediate Credit Banks have not met the approval of the Farm Loan Board. Frequently owners of large ranch properties incorporate their business and borrow funds for the benefit of firm members. Although the Agricultural Credits Act forbids the Intermediate Credit Banks to loan directly to individuals, an incorporated operating company authorized by its charter to borrow money may rediscount paper with these banks. Such business is very attractive from the point of view of the Intermediate Credit Banks because a few large loans to successful ranchmen, which carry the indorsement of an incorporated operating company, are more profitable than the same volume in smaller amounts indorsed by loan companies whose financial responsibility is not always certain. However, the Federal Farm Loan Board has questioned the propriety of discounting paper for these loan companies on the ground that it is too much like "direct loans" to individuals.²¹

The size of loans handled by the Intermediate Credit Banks in comparison with the average size of livestock loans is further evidence that their business consists pri-

²¹ We pointed out earlier in the chapter that the loan ratios of these semi-private cattle loan companies are very low, but in terms of dollar volume their business is of considerable importance to the Intermediate Credit Banks.

marily of the smaller, less profitable loans. A study of the size of range loans for 315 ranches in Montana, Wyoming, and the Dakotas for 1925 gives the following distribution for 2.4 million dollars of loans: 49 per cent were in amounts of \$100,000 or more; 42 per cent were between \$100,000 and \$10,000; and only 9 per cent were in amounts of \$10,000 or less.²² Although the Omaha Bank serves a similar territory only 15 per cent of its dollar volume of range loans is in amounts of \$100,000 or more, while in the mixed farming areas less than 12 per cent of the total is in amounts of \$10,000 or more. The predominance of small loans is apparent from the distribution of loans shown in the table on page 167.

Only four out of 165 range loans totaling nearly 3 million dollars are above \$100,000 in amount. Moreover, these largest loans were originated by semi-private corporations that do not loan to the general public but only finance members of the operating firm. Similar data from the Houston and Berkeley Districts would undoubtedly show a somewhat larger proportion of loans in the upper brackets, but until the larger livestock credit corporations utilize the discount facilities more freely the Intermediate Credit Banks will continue to receive a disproportionate volume of the less profitable business.

Thus despite the improvements in the credit practices of livestock credit corporations the advantages of these changes are not fully realized because the restrictions under which the Intermediate Credit system operates make it difficult to attract a larger portion of the livestock loan business. The appropriate remedies for this

²² Charles Iseard Bray, "Financing the Western Cattleman," *Colorado Agricultural Experiment Station Bulletin No. 338*, December 1928.

The average loan for cattle loan companies was found to be \$16,420 and for the Intermediate Credit Bank \$7,632, based on 1925 data.

TYPE AND SIZE OF LIVESTOCK LOANS IN THE OMAHA DISTRICT*

I. Range Loans^b

Size	Loans		Amount	
	Number	Percentage Distribution	In Thousands of Dollars	Percentage Distribution
\$ 4,999 or less . . .	41	24.8	120.2	4.3
5,000- 9,999 . . .	31	18.8	222.2	7.9
10,000-24,999 . . .	64	38.9	967.4	34.5
25,000-49,999 . . .	18	10.9	614.3	21.9
50,000-99,999 . . .	7	4.2	451.8	16.1
100,000 or more . . .	4	2.4	430.9	15.3
All loans	165	100.0	2,806.8	100.0

II. "Barn-Yard" Loans^c

\$ 499 or less . . .	313	17.5	104.1	4.0
500- 999 . . .	645	36.1	445.3	17.2
1,000- 2,499 . . .	599	33.5	858.9	33.2
2,500- 4,999 . . .	159	8.9	529.5	20.4
5,000- 9,999 . . .	54	3.0	356.7	13.8
10,000-24,999 . . .	15	0.9	239.8	9.3
25,000 or more . . .	2	0.1	54.0	2.1
All loans	1,787	100.0	2,588.3	100.0

* Data were obtained from the Omaha Bank and are based on discounts outstanding Aug. 30, 1930 for six livestock credit corporations making range loans and seven making "barn-yard" loans.

^b All credit corporations included have a loan limit above \$50,000 but only eleven loans exceed this amount.

^c Annual volume of business for these corporations is \$100,000 or above. Those with a smaller volume are omitted for their loans are not typical of the bulk of the livestock paper discounted with the Intermediate Credit Banks.

situation, and the role the Intermediate Credit Banks can be expected to play ultimately in the financing of our livestock industry, will be considered in more detail in Part III.

CHAPTER VIII

AGRICULTURAL CREDIT CORPORATIONS AND CROP PRODUCTION LOANS

Advocates of the Lenroot-Anderson bill expected the Intermediate Credit Banks to become an important source of short-time working capital for farmers. Their purpose, according to Secretary Wallace, was to provide a rural credit system which would promote more stable farm production and more orderly marketing. Loans for crop production purposes were considered as necessary as loans to livestock producers or co-operative marketing associations. By crop production loans are meant advances closely identified with outlays for cash crops, where prompt liquidation depends upon current crop returns.

Commercial banks have always been the most important single source for short-term production credit. They advance credit directly to producers having acceptable collateral or indirectly by financing mercantile and industrial concerns, who in turn extend trade credit to those farmers whose property or credit standing does not give them direct access to commercial bank loans. Non-banking sources of credit include general merchants and fertilizer manufacturers interested in selling farm supplies; commission firms, warehousemen, and cotton factors competing to handle the farmers' produce; and manufacturers and processors dependent upon agriculture for their supplies of raw materials. These trade groups either rediscount customers' notes or borrow on their own notes secured by their general assets or by growers' notes.

Dissatisfaction with these sources of production credit was responsible for much of the agitation for improvements in our rural credit system. Critics emphasized the cost of funds, the inadequacy and uncertainty of loan services in times of credit strain, and finally the power to depress prices and restrict the freedom of marketing crops which the control of production credit gave these creditor groups.¹

I. CROP PRODUCTION LOANS UNDER THE AGRICULTURAL CREDITS ACT

Several specific provisions were incorporated in the Agricultural Credits Act of 1923 to meet these objections to existing credit conditions. Interest rates were brought forcibly into line with open money market rates by limiting customers' rates to a definite percentage above the discount rate. Any change in this operating margin must be approved by the Farm Loan Board. If commercial banks fail to make contacts with the Intermediate Credit Banks, farmers or their business organizations may organize agricultural credit corporations to rediscount loans directly. Although discount privileges are limited to capital stock corporations, the Farm Loan Board, by placing the minimum capital at \$10,000, made certain that large capital requirements would not discourage the organization of credit corporations. Nor is a specific type of security required. Small farmers with their assortment of collateral may borrow if their security is sufficient to protect the credit corporation against loss. Thus supporters of the Agricultural Credits Act believed that by establishing more direct contact with outside money markets, and by regulating the interest

¹ For detailed discussion of these points see pp. 176-78.

rate charged, all farmers entitled to crop production credit could obtain ample funds at low rates.

The belief has gradually gained currency during the last decade that loans dependent on income from current crops as the primary source of payment are not desirable business for commercial banks of deposit. Crop failures and unprofitable agricultural prices endanger the incomes which guarantee the liquidity of such advances. Furthermore, declining land values have impaired the producer's equity in his land, which forms the ultimate security for his obligations. Whenever crop returns are insufficient to liquidate loans, renewals are inevitable, and the financing of succeeding crops may be necessary before repayment is secured. Since the deposits of commercial banks are largely demand liabilities, they cannot be tied up indefinitely; but agricultural credit corporations organized without deposit liabilities and with the privilege of rediscounting with the Intermediate Credit Banks are in a position to make loan commitments without reference to the behavior of deposits or depositors.

Agricultural credit corporations were organized promptly to take advantage of this new source of production credit. The first period of active organization began in 1925, coinciding closely with the period in which bank suspensions were assuming alarming proportions. Again when the banking situation became acute in 1930 a further expansion of local credit corporations occurred. The table on page 171 gives the total number of agricultural credit corporations established during the first seven years in the three districts from which two-thirds of all crop production loans originate, and the number of these accounts which were active at the close of 1929.

One-half of the credit corporations organized to finance crop production in these three districts previous to 1930 were established in the years 1925 and 1926. Two-thirds of these were in the Columbia District, where bank failures and declining deposits were rapidly reducing the available sources of credit. Although the

LIQUIDATION OF AGRICULTURAL CREDIT CORPORATIONS MAKING CROP PRODUCTION LOANS, 1923-29^a

District	Accounts Opened 1923-24		Accounts Opened 1925-26		Accounts Opened 1927-29		All Accounts Opened to Dec. 31, 1929	
	Total	Active Dec. 31, 1929	Total	Active Dec. 31, 1929	Total	Active Dec. 31, 1929	Number	Active Dec. 31, 1929
Columbia	11	7	43	28	17	14	71	49
New Orleans . .	4	3	10	6	9	5	23	14
St. Louis ^b . . .	16	4	10	2	7	5	33	11
Total	31	14	63	36	33	24	127	74

^a Data were obtained from the Intermediate Credit Banks.

^b It is not always possible to determine whether corporations are engaged primarily in making crop production loans or in financing livestock, but the ones included here are located in the cotton and rice areas of Missouri and Arkansas and make few, if any, loans on livestock.

mortality rate among discount corporations placing crop loans is extremely high, it is distinctly below that of livestock loan companies.² More than half of the corporations organized in the six years prior to 1929 maintained their discount relationship at the close of 1929. This greater vitality can be attributed to several circumstances. Some corporations are kept alive by the persistent demand for credit in those areas where bank failures have deprived entire communities of their usual credit facilities. Other corporations are still in existence merely because they are being liquidated over a period

² See Chap. VI.

of years rather than suddenly in order to minimize the losses to stockholders and to the discounting bank. A few, however, have attained some measure of success and promise to become a permanent part of the credit structure of their communities.

Special efforts were made in 1930 and 1931 to relieve the banking situation in agricultural areas by encouraging the organization of agricultural credit corporations. As a result more than 200 new corporations were established in this two-year period. Just what proportion of them finance crop production loans exclusively it is impossible to say, but their geographical distribution suggests that a majority are for this purpose.

Along with this rapid development in credit machinery, loans for crop production purposes increased steadily in dollar volume and in 1931 made up approximately one-third of the original discounts placed.³ In 1932 the volume of loans for crop production purposes declined, chiefly because many producers could no longer qualify for loans and were forced to go elsewhere for accommodation.⁴

Production loans are chiefly confined to the cotton and tobacco sections of the Southeast, the cotton areas of California and the Southwest, the sugar-cane district of Louisiana, the rice areas of Louisiana and Arkansas, and the trucking and fruit sections of Florida, New Eng-

³ See also chart on p. 128, which shows the volume of discounts outstanding made for crop production purposes.

⁴ Funds for crop production loans were provided for in the Act which authorized the creation of the Reconstruction Finance Corporation. The Crop Production Loan Office of the Department of Agriculture, which administered the funds, advanced approximately 65 million dollars to 511,000 farmers during the 1932 season. See paper delivered by Norman J. Wall at the 26th Annual Meeting of the American Farm Economic Association, Cincinnati, Ohio, December 1932.

land, and the Northwest. Although accurate data are not available to show the distribution of production loans between the various crops financed, the following estimate, which is based upon information obtained from the Intermediate Credit Banks and local credit corporations, gives the distribution of original loans for 1929 and is unlikely to be in serious error.

Commodity	In Thousands of Dollars	Percentage Distribution
Cotton and tobacco ⁵	\$12,700	64.5
Sugar cane	2,400	12.2
Rice	2,200	11.2
Potatoes	1,050	5.3
Fruits and vegetables	1,350	6.8
Total	<u>\$19,700</u>	<u>100.0</u>

Cotton loans are by far the most important, probably comprising between 55 and 60 per cent of all production loans. Since the exact distribution of loan proceeds is not reported, it is impossible to separate tobacco and peanut loans from cotton advances in the Southeast. But inasmuch as approximately one-third of all original crop production loans in 1929 was placed by nine credit corporations affiliated with cotton co-operative marketing associations, the estimate of 60 per cent is probably not too high for cotton advances.⁶ In 1929 sugar and rice planters together claimed approximately a fourth of the total amount advanced, while producers of semi-perish-

⁵ Loan proceeds may be used in part for the production of peanuts but except for the first few years few loans were made specifically for this purpose.

⁶ William H. Rowe, "Agricultural Credit Corporations Affiliated With Cotton Co-operative Marketing Associations," *U. S. Department of Agriculture Technical Bulletin No. 322*, September 1932, p. 19.

able and specialty crops received 2.4 million dollars, or 12 per cent of all original loans.

II. WHY VARIOUS INTERESTS HAVE ORGANIZED DISCOUNT CORPORATIONS

Many interests have participated in making Intermediate Credit Bank funds available for crop production purposes. Speaking broadly, the factors which have encouraged the organization of agricultural credit corporations are: (1) the demoralized banking conditions prevailing throughout the agricultural areas; (2) the extreme dependence of producers on high cost merchant credit; (3) the control exercised by creditors over mortgaged crops, which encouraged co-operatives to develop their own credit facilities; (4) the desire of trade groups to maintain any competitive advantage which the control of production credit affords; (5) a temporary production emergency in the sugar-cane industry which closed the usual channels of commercial credit; and (6) miscellaneous opportunities for personal profit which led independent business men to organize credit corporations. But neither the motives nor the immediate circumstances which led particular groups to organize credit corporations can be isolated in any clear-cut fashion, nor can a credit corporation as a going concern always be attributed to the efforts of any one group.

A demoralized banking situation throughout agricultural areas is probably the most important single cause for the rapid development of credit corporations specializing in crop production loans. Disastrous bank failures, particularly in the Columbia and St. Louis Districts, have left many communities without banking facilities. Surviving banks are in no position to increase their commitments and are very loath to assume con-

tingent liability as indorsers of producers' notes. Instead, they are anxious to strengthen their reserve position to meet unexpected withdrawals of cash by uneasy depositors. Normal loan operations are impossible so long as bank capital is systematically dissipated through the liquidation of insolvent banks or resources are impounded in institutions closed for reorganization. Under these conditions banking policies are directed toward the maintenance of solvency. Loans are curtailed; securities readily convertible into cash are substituted for local loans; protection of depositors' interests takes precedence over the credit needs of borrowers. Agricultural credit corporations are formed not only because they are free from any obligation to depositors but because they bring outside funds into the community at a time when local loan resources are exhausted.

In the cotton and tobacco areas, agricultural credit corporations with their privilege of rediscounting with the Intermediate Credit Bank are often the only source of cash credit. Studies based upon 1926 data show that trade credit and not cash loans comprises 42 per cent of the short-term credit in North Carolina⁷ and 36 per cent in Georgia.⁸ A similar situation also exists in Texas, Arkansas, and other cotton areas. And trade credit is costly. The average cost of merchant credit in North Carolina in 1926 was 25.2 per cent per annum and in Georgia 26.3 per cent. Fertilizer purchased at time prices carries an interest charge frequently amounting to 35 per cent annually. Agricultural credit corporations offered farmers who had depended upon trade credit a source of cash

⁷ "Farm Credit in North Carolina—Its Cost, Risk, and Management," *North Carolina Agricultural Experiment Station Bulletin No. 270*, April 1930, p. 7.

⁸ "Credit Problems of Georgia Cotton Farmers," *Georgia Agricultural Experiment Station Bulletin No. 153*, June 1929, p. 14.

credit which would relieve them of the excessive burden of time purchases.

Co-operative marketing associations entered the field of production credit in part for the purpose of reducing production costs for their members. One method of reducing costs is for the co-operative to retail fertilizer and other farm supplies and pass on any savings from quantity purchases to its members in the form of patronage dividends. Cash sales are essential, however, since co-operatives—particularly those of the non-stock type—have little working capital to tie up in accounts receivable and are not disposed to assume the risks of credit sales. If members can borrow from agricultural credit corporations which rediscount producers' notes with the Intermediate Credit Banks, the co-operative can operate its supply company on a cash basis.

The primary reason for co-operatives venturing into the field of production credit, however, was to promote co-operative marketing. Very early the state-wide cotton and tobacco associations realized that their members' dependence upon credit institutions indifferent or unfriendly to the co-operative movement prevented deliveries. Even if actual hostility did not exist, farmers who had pledged their crops to secure loans were pressed to pay their debts at harvest time. Creditors are less friendly to orderly marketing when it necessitates deferred payments to them as well as to members, and deferred payments are inevitable in co-operative marketing. If, in addition, creditors are engaged in business enterprises with which the marketing association competes, their control of production credit gives them a competitive advantage in obtaining deliveries. Co-operatives have been obliged to furnish a similar service or lose deliveries.

In this struggle for the control of mortgaged crops,

co-operatives utilized agricultural credit corporations. "We are going to set up credit groups all over the section. We are going to fight fire with fire and get delivery of crops."⁹ It was in this mood that many agricultural credit corporations were formed in the first few years. Since the crop mortgage system prevailed throughout most of the cotton and tobacco areas, all co-operatives faced this problem of securing deliveries. As a result they either encouraged the formation of credit corporations friendly to co-operative marketing or organized their own credit subsidiaries.

Trade creditors also saw opportunities to increase their business by organizing agricultural credit corporations to rediscount producers' notes. Merchants, cotton factors, warehousemen, cotton-seed oil mills, fertilizer manufacturers, and sugar refineries were willing to relinquish their credit functions to cash lending institutions whenever this shift was possible without prejudice to their major business of selling supplies or services. Recently the competition of cash chain stores in rural areas has been threatening to take away the more profitable cash customers of the so-called time merchants unless they meet cash prices. Fertilizer concerns are anxious to place their business more nearly on a cash basis. A fertilizer manufacturer expressed a common feeling when he said: "Our firm is withdrawing as rapidly as possible from an extensive banking business which it has inadvertently assumed."¹⁰ The noticeable decline in the proportion of short-term credit obtained from trade sources in 1926

⁹ A. E. Bing, secretary, North Carolina Cotton Growers' Co-operative Association, "Co-operative Production Credit for Members," *Proceedings of the Third National Co-operative Marketing Conference*, January 1925.

¹⁰ A conversation with the president of Lyons Fertilizer Company, Tampa, Fla.

is evidence of the widespread dissatisfaction with the combination of credit functions with mercantile pursuits.¹¹

Trade groups which are interested in maintaining control over the crop itself rather than in obtaining cash loans for producers may organize their own credit corporations. Manufacturers, processors, and other commercial interests finance producers in order to assure a supply of raw material or in return for the privilege of storing, selling, or processing their crops. They require delivery of the crop instead of cash payment. The Intermediate Credit Banks will discount their customers' notes if indorsed by a qualified discount corporation. This opportunity to substitute an incorporated loan company accepting only well-secured notes for open book accounts and the lax credit practices often accompanying them has encouraged many creditor groups to organize credit corporations.

A production emergency in the cane-sugar industry which closed the usual channels of commercial credit forced sugar planters to draw upon outside sources for their production requirements. Beginning about 1923, sugar planters of Louisiana faced an unprofitable period of indefinite duration because of the rapid spread of the mosaic disease. Unless old varieties of cane were replaced by plants immune to this disease, sugar-cane culture in Louisiana was threatened with destruction.¹² With the industry facing this precarious transition period commercial banks were unwilling to finance current produc-

¹¹ David L. Wickens, "Credit Study in the Southeast Reveals Shift to Cash Loans," *Yearbook of Agriculture*, U. S. Department of Agriculture, 1927, p. 242.

¹² This disease, which stunts the growth of the plant and greatly reduces the sugar content of the cane, appeared in 1919 but caused little damage the first few years. After this period it spread rapidly, infecting the entire sugar-cane area.

tion. Since sugar refineries are immediately concerned with any emergency which may cut off their supply of cane, the refiners united with the New Orleans banks and planters in an effort to obtain production loans from the Intermediate Credit Banks.

Besides these specific groups, each with its own well-defined objective, miscellaneous interests have organized agricultural credit corporations. Farm bureau federations, state extension divisions, editors of farm papers, and private citizens with no thought of direct personal profit have been active in developing credit corporations in their respective communities. Occasionally a young lawyer wishing to supplement a limited practice by preparing loan applications, clearing titles, and searching records organizes a credit corporation and is retained as its secretary. A bank cashier whose institution has failed may continue to operate the agricultural credit corporation formerly affiliated with his bank. Whether the objective is a part-time job, increased sales of supplies and services, the strengthening of the co-operative movement, the supplementing of rural banking services, or more disinterested motives, the range of interests participating in the development of local credit institutions remains a distinctive feature of the development of local facilities for supplying production credit.¹³

III. SOURCE OF CAPITAL FUNDS

It would seem, from the number of groups participating in the formation of credit corporations, that the raising of capital from these sources would be relatively simple. But willingness to control and benefit from the

¹³ See Chap. XV for a discussion of the efforts of the federal government to meet the emergency situation of 1930-32 by aiding in the establishment of agricultural credit corporations.

organization of an agricultural credit corporation does not always carry with it a disposition to furnish the necessary capital investment. Private capital is not readily drawn into the crop production loan business at a time when unprofitable agricultural operations are held responsible for much of the banking distress in rural communities. Instead of investing permanently in credit corporations, commercial banks, business men, and even cooperative associations frequently advance the original capital with the intention of transferring their shares to borrowers as rapidly as possible. In other cases business interests subscribe the legal minimum and supplement their investment by the sale of additional shares to borrowers. With these progressive shifts in stockholdings, it is difficult to determine the actual source of capital funds. Although any estimate is subject to considerable error, the distribution of capital investment shown in the accompanying table indicates the relative stakes of various groups in the credit corporations specializing in crop production loans.

Individual borrowers have subscribed such a large portion of the invested capital for the sole reason that purchase of stock is often a prerequisite for a loan. A stock purchase requirement equal to 10 per cent of the original loan is customary, but occasionally the management requires each borrower to furnish sufficient capital to maintain the required relation between capital investment and discounts. Since the loan expansion of credit corporations making production loans ranges from three to seven times their capital investment, a borrower may be obliged to invest an amount equal to 15 or 20 per cent of his loan.¹⁴

¹⁴ See p. 190 for the loan ratios of agricultural credit corporations making crop production loans.

Non-borrowers are reluctant to assume the risks of capital losses if they can be readily shifted to borrowers. Even co-operative marketing associations have been prone to transfer the responsibility for raising capital to members using the loan services, although a few co-operatives

DISTRIBUTION OF CAPITAL INVESTMENT OF AGRICULTURAL CREDIT CORPORATIONS SPECIALIZING IN CROP PRODUCTION LOANS, 1929^a
(As percentages of total capital)

Shareholders	Columbia District	New Orleans District	St. Louis District
Individual borrowers	49.9	43.9	59.5
Co-operative marketing associations	37.1 ^b	6.0	— ^c
Business interests (warehousemen, fertilizer dealers, cotton factors, sugar refineries, etc.)	10.0	40.7	16.1
Commercial banks	1.7	9.4	11.5
Unclassified ^d	1.3	—	12.9
All classes	100.0	100.0	100.0

^a The percentages in this table are based upon 1929 data secured from the Intermediate Credit Banks and individual agricultural credit corporations.

^b The Growers' Loan and Guaranty Company, a subsidiary of the Florida Citrus Exchange, accounts for the large proportion subscribed by co-operatives. If this corporation were omitted, the proportion of the capital furnished by co-operatives would be less than 3 per cent, and the amount supplied by borrowers would be increased to 86.5 per cent.

^c Originally the Arkansas Rice Growers' Co-operative Association sponsored a credit corporation, but a reorganization in 1929 separated the two organizations.

^d Directors' qualifying shares make up the larger portion of this group and might well be classed with banking or business interests.

have used their reserves to capitalize credit subsidiaries without asking borrowers to purchase stock. Another method used by co-operatives is to allow members to assign their equities in reserve funds and to supplement them by cash subscriptions if more capital is needed. The Arizona Pima Cotton Growers' Association persuaded a

processing plant in which the co-operative owned shares to organize a credit corporation to finance all its customers—members and non-members alike. The Staple Cotton Discount Corporation at Greenwood, Mississippi, was organized by the Staple Cotton Co-operative Association and both are controlled by the same management, but the marketing association did not supply the original capital. Cotton growers and commercial banks were required to subscribe to stock in an amount equal to one-tenth of their loans.¹⁵

Likewise, commercial banks and business interests which operate agricultural credit corporations as adjuncts of their major enterprises share with borrowers the responsibility for raising capital. The extent to which business firms are willing to assume the risks of capital losses depends upon several factors. If their purpose is actively to stimulate production or increase the sale of supplies it may not be good policy to serve only those applicants willing to purchase stock. Furthermore, if business firms anticipate immediate benefits from the loans placed and expect no serious losses they can well afford to absorb in their trading profits the normal risks of bad debts.¹⁶

Many merchants, fertilizer dealers, and warehousemen, however, prefer to make borrowers responsible for the necessary capital. One fertilizer dealer devised an in-

¹⁵ A similar arrangement was followed by the North Carolina Agricultural Credit Corporation and the South Carolina Agricultural Loan Association, which originally confined their loans to members of the cotton and tobacco co-operatives. After the first year or two these corporations loaned to all applicants offering satisfactory collateral without reference to their membership in any co-operative association.

Now that the Farm Board makes loans to co-operative marketing associations for the purpose of capitalizing credit corporations, there is less reason for requiring borrowers to purchase stock. See Chap. XIV.

¹⁶ Sugar refiners and commercial banks which are closely dependent upon the prosperity of the sugar industry contributed most of the capital for the agricultural credit corporations financing cane production.

genious substitute for compulsory stock subscriptions, but it made his customers' notes ineligible for discount. Borrowers could purchase stock if they liked but, if they preferred to pay slightly more than the regular cash price for fertilizer in lieu of purchasing stock, they were given this option. The Intermediate Credit Bank objected to this arrangement on the ground that an applicant, by relinquishing his right to cash terms for fertilizer, is in effect paying more for his loan than the corporation is authorized to charge. Although borrowers preferred the higher price for fertilizer to the necessity of buying stock, a voluntary election to pay such a premium was held not to be permissible.¹⁷

A few commercial banks subscribe and permanently hold the entire capital stock of the credit corporations they control. But when they do so they ordinarily make little effort to expand their services and confine their loans to the immediate locality and to highly selected credit risks. A branch banking system, however, through its local branches, is able to develop a considerable volume of business with a minimum of expense. Consequently an affiliated credit corporation is usually an active subsidiary intent upon maximizing bank income rather than a service auxiliary designed to accommodate a limited number of deserving customers.¹⁸

¹⁷ As yet, the stock purchase requirement has not been attacked on the ground that it indirectly allows a usurious rate. Whether such a distinction between these two devices is defensible will be considered when we discuss the cost to borrowers of their stock purchases.

¹⁸ The Calcasieu National Bank of Lake Charles, La., which operates branches in the southwestern counties of the state, organized an agricultural credit corporation as a subsidiary. For some time the corporation placed nearly a million dollars of loans annually. The Calcasieu Bank has contributed largely to the capital, but there is also a stock purchase requirement equal to 5 per cent of the loan. In addition, customers were required to contribute another 5 per cent to a loss reserve. Now that the Farm Loan Board has held that requiring

Although the burden of supplying capital has rested largely with producers, the management of agricultural credit corporations is left to any group that sees any advantage in rediscounting crop production loans with the Intermediate Credit Banks. Consequently we have at the present time several hundred agricultural credit corporations sponsored by a variety of interests and having only a casual connection with our established commercial banking system. Since the Agricultural Credits Act itself makes very few stipulations in regard to the business practices of credit corporations which rediscount with the Intermediate Credit Banks, this important function devolves upon the banks themselves.

IV. BUSINESS PRACTICES OF AGRICULTURAL CREDIT CORPORATIONS

It is inevitable that the business practices of agricultural credit corporations should be scrutinized closely by the Intermediate Credit Bank discounting their paper since credit corporations are subject to comparatively few legal restrictions. Moreover, the discounting banks must confine their loans to financially responsible credit corporations for they are required to operate on a margin of 1 per cent and hence are unable to absorb heavy losses on discounted paper. Unfortunately, the indorsements of corporations handling crop production loans have been notoriously poor guaranties that discounted notes can be taken up promptly at maturity.

One reason that the indorsements of credit corporations are unreliable is because the amount of paid-in capital for a majority of credit corporations is not much

borrowers to contribute to loss reserves makes a corporation's paper ineligible for discount, the credit corporation may increase its stock purchase requirement.

in excess of the required minimum. By placing the capital requirements as low as \$10,000 the Farm Loan Board made possible the organization of many credit corporations with very limited resources. With the convenient device of collecting capital from customers it might be assumed that capital resources would exceed the minimum. But in spite of the possibility of expanding in this manner, a majority of the credit corporations making crop loans have paid-in capital of less than \$25,000. The predominance of small corporations is apparent from the table on page 186.¹⁹

In the Columbia District 39 corporations, all with capital and surplus of less than \$100,000, originate 59 per cent of all discounts, although they control only 37 per cent of the capital resources. The five corporations with an average investment of \$300,000 account for 41 per cent of the discounts, although they control 63 per cent of the capital investment.²⁰ In the St. Louis District previous to the fall of 1930 no corporation making crop production loans had a capital investment in excess of \$35,000, and the average annual volume of discounts for the largest loan company was around \$100,000. Even with the present tendency to organize somewhat larger credit corporations, in June 1932 none had a capital in excess of \$100,000.²¹ In contrast with the predominance of small corporations in the Columbia and St. Louis Districts, 60 per cent of all paper in the New Orleans Dis-

¹⁹ The Emergency Relief and Construction Act, which was passed July 21, 1932, authorized the Reconstruction Finance Corporation to set up regional credit corporations with paid-in capital of not less than 3 million dollars. See Chap. XV.

²⁰ The Growers' Loan and Guaranty Company, Tampa, Fla., has a capital and surplus of \$660,000, but at the date used for this analysis it was discounting less than \$150,000 for loans.

²¹ See footnote *b* to table on p. 186.

PREDOMINANCE OF SMALL CREDIT CORPORATIONS IN MAKING CROP
PRODUCTION LOANS^a

Classification (Capital and surplus)	Number of Cor- porations	Capital and Surplus		Discounts	
		In Thou- sands of Dollars	As Per- centage of District Total	In Thou- sands of Dollars	As Per- centage of District Total
COLUMBIA DISTRICT					
(JUNE 1928)	44	2,422.7	100.0	6,321.0	100.0
\$ 10,000- 24,999	29	378.3	15.6	1,881.2	29.8
25,000- 99,999	10	524.0	21.7	1,823.5	28.8
100,000-499,999	4	860.4	35.5	2,473.9	39.1
500,000 or more	1	660.0	27.2	142.4	2.3
NEW ORLEANS DISTRICT					
(SEPT. 30, 1931)	16	1,777.4	100.0	7,936.6	100.0
\$ 10,000- 24,999	6	70.5	3.9	271.5	3.4
25,000- 99,999	5	234.1	13.2	759.7	9.6
100,000-499,999	3	410.7	23.1	1,825.5	23.0
500,000 or more	2	1,062.1	59.8	5,079.9	64.0
ST. LOUIS DISTRICT					
(AUG. 30, 1931) ^b	13	206.2	100.0	889.1	100.0
\$ 10,000- 24,999	11	150.7	73.1	612.0	68.8
25,000- 99,999	2	55.5	26.9	277.0	31.2
100,000-499,999	—	—	—	—	—
500,000 or more	—	—	—	—	—

^a All data were obtained directly from the Intermediate Credit Banks. Although the data for the three districts are for different dates the comparability of districts or the distribution of size groups is not affected.

^b By June 1932 there were 51 credit corporations in the St. Louis District specializing in crop production loans but none had capital and surplus in excess of \$100,000. Thirty-four, which had less than \$25,000 of capital and surplus, comprised 41 per cent of the total investment and handled 36 per cent of the discounts. Seventeen had an average capital investment of \$41,000 and originated 64 per cent of all discounts. These data were obtained from the Farm Loan Bureau.

trict is discounted for two corporations, each having capital and surplus exceeding half a million dollars. Less than 15 per cent of the paper originates with the eleven corporations having an average capital and surplus of less than \$50,000.

Even more significant than the tendency to organize with minimum capital is the fact that nominal capital is frequently not paid-in capital at all. Payment for capital stock is often deducted from the proceeds of the first loan and represents an indebtedness of the borrower.²² Many farmers in need of credit, and who are acceptable credit risks, are unable to pay for their stock except by borrowing. Local managers faced with the necessity of increasing their capital in order to qualify for a satisfactory line of credit are not inclined to inquire too closely into the source of funds for the purchase of shares. When a loan application is filed a check for the stock subscription may be tendered, with the understanding that it is to be held until the proceeds of the loan are remitted to the borrower. Such an arrangement is justified on the ground that the loan application may be rejected. In this case the check is returned; meanwhile the applicant's cash balance has not been affected. This procedure, however, makes it very simple for an applicant to arrange for a temporary loan to cover the check. He then liquidates the loan from the proceeds of his note.

This convenient method of paying for stock is discouraged in order to improve the financial responsibility of discount corporations. If paid-in capital is to protect the discounting bank it should be a bona fide investment, not an indebtedness of the farmers accommodated. If the amount of the stock subscription is deducted from the proceeds of the loan, the Intermediate Credit Bank itself furnishes this additional factor of safety but receives

²² The Farm Loan Board, as well as the Intermediate Credit Banks, has warned corporations that no proceeds of a loan should be used either directly or indirectly to purchase stock in the credit corporation. Regardless of the disapproval of the Board, the practice apparently continues.

no security other than the pledge of this stock and the collateral underlying the loan which this capital purports to guarantee.²³ Only after the successful liquidation of the original loan does this capital become paid-in and available as additional security for outstanding discounts. If a bad crop year results in an excessive carry-over of loans, the corporation is without liquid resources to take up rediscounted paper. The restriction of discount privileges to capital stock corporations becomes meaningless if capital is supplied by means of loans from the Intermediate Credit Banks.²⁴ However, this practice of borrowing either from the Intermediate Credit Banks or elsewhere to obtain the required capital cannot be avoided except by restricting accommodations to producers who have accumulated sufficient working capital to permit them to invest voluntarily in a loan company from which they expect advantageous services. Otherwise the Intermediate Credit Banks must satisfy themselves as to the security underlying individual farmers' notes as well as keep a continuous check on the solvency of the discount corporation itself.

Because the capital investment of many agricultural

²³ In 1931 and 1932 government loans were made to borrowers who wished to purchase stock in agricultural or livestock credit corporations. See Chap. XIII for a detailed account of these advances.

²⁴ A recent decision of the Supreme Court of North Dakota holds that "To the extent that the proceeds of such loan might have been used for the purchase of stock as a part of the permanent capital of a private corporation in the loaning business, it would, of course, not have been used in the first instance for an agricultural purpose. The Act of Congress referred to . . . nowhere authorizes the purchase or discount of paper given to finance agricultural credit corporations as private corporations. The Act differs in this respect from the Act of Congress July 17, 1916, relating to the capital stock of Federal Farm Loan Banks and federal farm loan associations which are co-operative." *Agricultural Credit Corporation v. Heim*, (Supreme Court of North Dakota, July 16, 1932), *North Western Reporter*, Vol. 243, p. 809.

credit corporations is neither ample in amount nor always substantial in character, the Intermediate Credit Banks restrict the loan expansion of agricultural credit corporations and the form in which they hold their capital investment. The convenient device of collecting capital from customers leaves the management of credit corporations curiously free to expand its volume of business without let or hindrance, since loans may be increased so long as discounts maintain a prescribed relationship to unimpaired operating capital. Theoretically, a loan expansion of ten times the unimpaired capital and surplus is possible, but the actual loan ratio approved and the estimate of capital impairment are left to the discretion of the Intermediate Credit Banks. This discretionary power gives them an effective control over the amount of business a credit corporation can undertake on a given capital investment.

At the beginning of each loan season, examiners from the Intermediate Credit Banks, with the help of local officers, appraise the assets of all credit corporations applying for discount privileges. All worthless notes are charged against their capital and appropriate allowances are made for fair and doubtful accounts.²⁵ If past due paper cannot be shaped up in a manner acceptable to the Intermediate Credit Bank, these notes must be taken up by the credit corporation. A line of credit from three to eight times the unimpaired capital and surplus is usually allowed to corporations financing crop production loans, although the loan ratio of new corporations or those facing unusual hazards may be lower. The number of cor-

²⁵ The working rule followed by the Columbia Bank is to deduct 50 per cent of the value of doubtful paper and 25 per cent for notes classed as fair. Operating capital is reduced by the amount of these estimated losses.

ALLOCATION OF DISCOUNTS AMONG CORPORATIONS HAVING SPECIFIED LOAN RATIOS*

(Agricultural credit corporations making crop production loans)

Loan Ratio	Number of Corporations	Discounts	
		In Thousands of Dollars	As Percentage of Respective Totals
COLUMBIA DISTRICT^b.....	43	6,178.6	100.0
Less than 3.5:1.....	10	403.6	6.5
3.5:1-4.9:1.....	12	1,617.0	26.2
5.0:1-6.4:1.....	12	2,438.5	39.4
6.5 or more to 1.....	9	1,719.5	27.9
NEW ORLEANS DISTRICT.....	16	7,936.8	100.0
Less than 3.5:1.....	6	1,636.7	20.6
3.5:1-4.9:1.....	5	925.8	1.2
5.0:1-6.4:1.....	4	1,658.3	20.9
6.5 or more to 1.....	1	3,715.8	57.3
ST. LOUIS DISTRICT.....	13	889.1	100.0
Less than 3.5:1.....	2	48.4	5.4
3.5:1-4.9:1.....	2	124.0	14.0
5.0:1-6.4:1.....	7	439.6	49.4
6.5 or more to 1.....	2	277.1	31.2
ALL THREE DISTRICTS.....	72	15,166.7	100.0
Less than 3.5:1.....	18	2,251.1	14.8
3.5:1-4.9:1.....	19	2,666.8	17.6
5.0:1-6.4:1.....	23	4,536.4	29.9
6.5 or more to 1.....	12	5,712.4	37.7

* The data were obtained from the Intermediate Credit Banks and are of the same date and for the same corporations as are the data in the table on p. 186, with one exception. The Growers' Loan and Guaranty Company has been omitted from the Columbia District because its discounts were negligible in quantity and its loan ratio therefore unrepresentative.

^b The loan ratios for the corporations in this district may be under-stated inasmuch as the maximum discounts for corporations financing sugar planters occur somewhat later in the season than the date used in this table. A loan ratio of 4 to 1 may be considered representative.

porations normally having a loan ratio far below the legal maximum, and the proportion of discounts originating in each loan-ratio group are shown in the table on the opposite page.

One-fourth of the credit corporations covered by the table on page 190 have a loan expansion of less than 3.5 to 1, but together they place less than 15 per cent of the total loans. A number of these corporations are affiliated with commercial banks or business firms that accommodate a small number of carefully selected credit risks. Others have recently qualified for discount privileges and are not encouraged to utilize a maximum line of credit.

Only 12 of the 72 credit corporations are granted a loan expansion of 6.5 or more to 1, but these corporations originate 38 per cent of all discounts. Nearly one-half of the corporations, however, pyramid their operating capital at least 5 to 1, and together they rediscount two-thirds of all the loans. These loan ratios, which are far below the legal maximum, reflect the conservative policies of the Intermediate Credit Banks in their efforts to strengthen the indorsement of the corporations for whom they discount paper.

Another method of strengthening the indorsement of credit corporations is to require them to hold their capital investment in a highly liquid form. A few corporations approach the legal maximum of credit expansion, but only if a major portion of their capital is in the form of readily marketable bonds and securities. The proportion of capital investment which corporations hold in the form of liquid securities is shown in the table on page 192.

Agricultural credit corporations with the most moderate loan expansions quite often maintain the largest

LIQUIDITY OF CAPITAL INVESTMENT OF AGRICULTURAL CREDIT CORPORATIONS MAKING CROP PRODUCTION LOANS^a
(Dollar items are in thousands)

Loan Ratio	Net Operating Capital ^b	Discounts	Additional Collateral		Bond Reserves as Percentage of Discounts
			Bonds	Notes Receivable	
COLUMBIA DISTRICT	\$1,262.9	\$6,178.6	\$612.6	\$887.0	9.9
Less than 3.5:1	203.0	403.6	154.2	1.8	38.2
3.5:1-4.9:1	396.9	1,617.0	165.2	122.6	10.2
5.0:1-6.4:1	436.9	2,438.5	210.2	415.9	8.6
6.5 or more to 1	224.9	1,719.5	83.0	346.7	4.8
NEW ORLEANS DISTRICT	1,777.3	7,936.6	1,303.3	668.3	16.4
Less than 3.5:1	645.5	1,636.7	579.9	25.0	35.4
3.5:1-4.9:1	215.5	925.8	328.7	—	35.5
5.0:1-6.4:1	354.2	1,658.3	294.7	—	17.8
6.5 or more to 1	562.1	3,715.8	100.0	643.3	2.9
St. Louis District	206.2	889.1	171.3	—	19.3
Less than 3.5:1	20.0	48.5	20.0	—	41.3
3.5:1-4.9:1	35.6	124.0	30.1	—	24.2
5.0:1-6.4:1	95.1	439.6	80.0	—	18.2
6.5 or more to 1	55.5	277.1	41.2	—	14.9

^a Data were received directly from the Intermediate Credit Banks and cover the same corporations classified in the table on p. 186, with one exception. The Growers' Loan and Guaranty Company is omitted from the Columbia District because at this date its loan expansion was quite unrepresentative.

^b In the case of corporations in the Columbia District the figures for net operating capital represent the estimate of examiners as to unimpaired capital. That is, uncollectable paper has already been charged against the capital account. Similar figures were not available for the New Orleans and St. Louis Districts, but the condition of a majority of the corporations in these districts active at this time warrants the assumption that the book figures for capital and surplus are impaired only slightly.

bond reserves. Corporations with loan expansions less than 3.5 to 1 have pledged bonds equal to 35 per cent or more of their total liability as indorsers. The percentage of bond reserves declines steadily as the loan ratios increase until we find that the corporations which pyramid their capital 6.5 times or more have an average bond reserve equal to less than 4 per cent of their rediscount liabilities.

In general two conditions explain the failure to maintain more substantial bond accounts. In the first place the Intermediate Credit Bank may not insist upon a large bond account in the case of well-managed corporations with substantial capital resources, or if the credit corporation is affiliated with a business enterprise that is financially able and stands ready to take up past due notes. Unfortunately, this does not describe the situation of many of the corporations whose percentage of liquid reserves is low. Most of the corporations with a small percentage of reserves have gradually exhausted their bond account. Inasmuch as bond reserves are held against specific contingencies, they cannot remain intact if losses cannot be met out of current income and uncollectable paper continues to accumulate. In this event the Intermediate Credit Bank ordinarily requires the corporation to dispose of its security holdings and take up delinquent paper.²⁶

But merely to prevent excessive pyramiding of capital investment and to maintain the solvency of local dis-

²⁶ These past due notes and sometimes other receivables are pledged as additional collateral in lieu of the bonds which were sold. Since these receivables are no more liquid than the rediscounts they purport to secure, the corporation's ability to honor its indorsement promptly is not enhanced although the additional collateral notes may provide a further margin of safety.

count corporations is not sufficient. Agricultural credit corporations, with the active co-operation of the discounting banks, have formulated loan policies designed to safeguard individual advances and avoid any impairment of capital resources. What these policies have been, and the measure of success achieved in making credit corporations a dependable source of production credit, will be discussed in the following chapter.

CHAPTER IX

ADMINISTRATION OF CROP PRODUCTION LOANS

Since each Intermediate Credit Bank has considerable latitude in determining the credit standards which corporations in its district must observe if they wish discount privileges, and because the character of the problems differs widely between districts, it is difficult to state definitely what the prevailing loan policies are.

The effectiveness of particular loan policies and methods varies in accordance with the commodity financed, production conditions, and the prevailing type of marketing arrangements. The widespread areas within which cotton and tobacco are produced give rise to problems in financing which do not appear in connection with the strictly localized production of rice or sugar cane. Likewise the marketing arrangements peculiar to the several crops introduce variables which must be considered in making specific crop production loans. Growers of cotton and tobacco, for instance, can find a purchaser at every country shipping point, while necessary milling and processing for rice and sugar cane determine to a considerable extent the channels through which the product will move. Consequently a crop lien on cotton and tobacco gives creditors some control over the means of repayment, while a lien on less easily marketable products does not increase the likelihood of liquidation unless the creditors have market contacts which enable them to dispose of the crop readily.

The variety of crops raised, production conditions, and marketing arrangements in the Columbia, New Orleans,

and St. Louis Districts offer a good test of the effectiveness of particular loan policies. Moreover, two-thirds of all production loans handled by the Intermediate Credit Banks originate in these districts. For these reasons the following discussion will be based primarily upon experience in financing growing crops within these areas.

I. POLICIES DESIGNED TO PROTECT CORPORATIONS FROM LOSS

In general these policies are directed toward several specific objectives, all contributing to the safety of the paper handled. These objectives may be summarized briefly as follows: (1) the elimination of all loan applications which involve any appreciable risk of loss; (2) the maintenance of adequate security throughout the life of the loan; (3) the establishment of conservative loan limits which will insure liquidation of production loans from crop receipts; (4) a close supervision over the expenditure of proceeds from loans; and (5) a collection system which assures the application of crop receipts to the liquidation of production loans.

A. Elimination of Applications Involving Appreciable Risk

The Intermediate Credit Banks, before extending discount privileges to credit corporations, investigate the competency of the prospective management to judge credit risks. Once granted a line of credit the loan committees of credit corporations are urged to pass upon all loan applications with considerable care. Every borrower must submit a recent financial statement accompanied by an attorney's certificate or other satisfactory evidence showing all outstanding liens and judgments on real

estate or personal property. The care with which these items are verified differs widely. One local committee considers it necessary before approving the loans of new applicants to check the judgments and real estate mortgages for the preceding ten years, chattel mortgages for the past three years, and crop liens for the current year.

After a loan application has been approved by the local committee the note and supporting papers are usually submitted to the Intermediate Credit Bank for final approval.¹ This scrutiny by the discounting bank results in many rejections. Although quantitative data are not available to show the volume of paper rejected, the Columbia Bank estimates that in 1929 it would have discounted five times its actual volume if it had accepted all paper offered.² In the 1928-29 season a Florida corporation with a high credit standing had loans rejected or reduced by an amount equal to 20.4 per cent of the total dollar volume offered for rediscount. These rejections were in addition to the loan applications which were eliminated by the local loan committee.³

Comparatively few local loan committees attempt to pass judgment upon an applicant's production program

¹ Some of the Intermediate Credit Banks are now attempting to require the credit corporations to take final action upon loan applications and to advance the proceeds to the borrowers before the notes are offered to the Intermediate Credit Banks for rediscount. Such a policy works hardships upon corporations whose resources are limited and whose local management is not entirely certain of the credit standards of the Intermediate Credit Bank. As yet a majority of the credit corporations making crop loans accept loan applications subject to favorable action by the Intermediate Credit Banks.

² Conversation with F. H. Daniels, president, Columbia Intermediate Credit Bank, November 1929.

³ The Texas Finance Corporation in 1926-29 rejected 26.3 per cent of the total amount applied for, or 39.6 per cent of all loan applications. See William H. Rowe, *The Texas Cotton Growers' Finance Corporation* (preliminary mimeographed report), Bureau of Agricultural Economics of the U. S. Department of Agriculture, March 1931.

before approving his loan, although it is now a general practice to refuse loans if producers do not raise their own feed supplies. Some corporations encourage borrowers to take advantage of the advice of agricultural extension divisions or similar services in planning their production programs or in improving their crop yields.⁴ But no systematic efforts have been made to refuse credit to farmers who do not co-operate with the federal and state departments of agriculture, and no criteria have been established for judging a satisfactory farm program from the point of view of safety of crop advances.⁵

Agricultural credit corporations financing cane-sugar production have gone somewhat further than other financing institutions in withholding accommodation if production programs do not meet with approval. The State Agricultural Credit Corporation of New Orleans realized the risks involved in making loans on sugar cane that was susceptible to the mosaic disease, but sugar refineries and industries dependent upon cane production were reluctant to keep land out of cultivation. Nevertheless the indiscriminate planting of old varieties could

⁴ The Louisiana Farm Bureau Credit Corporation, which operated for a season or two, stipulated that applicants must follow a production program approved by the state experiment station.

The Calcasieu Agricultural Credit Corporation requires rice planters to avail themselves of the seed grading and testing services that are furnished by the federal and state grading office. Paul Zimmerman (treasurer, American Rice Growers' Co-operative Association, Lake Charles), "Financing the Production of Rice," *American Co-operation*, 1929, p. 491.

⁵ In an oral statement reported in the *United States Daily* on Mar. 4, 1930 James C. Stone makes this comment: "A credit corporation would be wise in refusing to make loans to farmers or groups of farmers who did not obey the proper agricultural program. . . . The Farm Board, however, has made no arrangement with the Federal Reserve system or any other governmental credit agency to refuse loans to farmers who fail to comply with the Board's program."

not be permitted if loans were to be reasonably secure, and in 1926 a loan policy was adopted which provided that

no advances should be made on the old stubble until each individual field on which loans are requested has been carefully inspected and the fields considered advisable to cultivate indicated to the local or general committee of the corporation by the inspector. The planter should then bind himself to plant only those vigorous fields approved by the inspector.⁶

This close supervision of production programs was possible because planters in need of credit had little choice except to conform to the requirements of the credit corporation. Furthermore sugar production is concentrated in southeastern Louisiana, and loans are made to large-scale producers whose borrowings are sufficiently large to justify the inspection service necessary to enforce loan regulations.⁷

Another method of eliminating doubtful credit risks is to accommodate only borrowers who are able to pay even in the event of a complete crop failure.⁸ This practice, if followed, would restrict loans to producers able to pledge salable collateral with a liquidation value equal to the amount of their loans. Thus credit would be withheld from all producers except those whose financial status would allow them to borrow freely from commercial banks. Although agricultural credit corporations do not follow such a conservative policy they do require adequate collateral for their loans.

⁶ Memorandum by Arthur H. Rosenfeld (consulting technologist), *Sugar Bulletin*, Sept. 1, 1926.

⁷ The corporation is permitted to charge the borrower a small fee per acre to reimburse it for inspection expenses.

⁸ See *Staple Cotton Review*, January 1929, in which this policy was announced.

B. Maintenance of Adequate Security

Crop mortgages are taken as collateral in all cases but, since the value of prospective crops is highly uncertain, crop liens alone are not considered adequate security. Moreover, a legal claim to the proceeds from the sale of mortgaged crops is of little value if court action is necessary to enforce the lien, for a jury comprised largely of farmers is loath to convict a neighbor on a charge of misapplying the proceeds. Hence agricultural credit corporations require one or more of the following as additional security: (1) mortgages on personal property and real estate, (2) crop insurance policies, (3) indorsements of landlords or affiliated marketing agencies.

The pledge of chattels or even real estate affords uncertain protection to creditors. Even if production loans are limited to a conservative estimate of the liquidation value of working equipment and livestock, which is the common practice, farm implements, work animals, and other livestock can seldom be disposed of at the close of unprofitable crop years except at great sacrifice. Real estate mortgages, especially since those offered as collateral are almost invariably junior liens, do not insure prompt liquidation of notes at maturity and seldom add anything to the ultimate safety of the loan. In many cases declining land values have wiped out the owner's equity in his land and in any case the paralyzed market for farm property prevents creditor's from realizing on such collateral. The following report from an Intermediate Credit Bank examiner illustrates the difficulties encountered in realizing on property pledged to secure loans.

It [the note] is secured by mortgage over four mules, one of which has died; the other three are in the hands of the cor-

poration; also fourteen head of cows, five of which have died, two having been sold for taxes, the remaining seven being in the hands of the corporation. . . . We also hold as additional security mortgage over twenty-five acres of land, about one acre being cleared. The value of this real estate is very doubtful. There is nothing more that can be done with this paper now.

A more hopeful report, submitted at the same time, reads as follows:

He has recently secured a job with the county and expects to retire this balance from his salary.

A second source of income, whether it be from a few dairy cows, a second crop, or another job, represents more security to creditors than the pledge of property of doubtful liquidation value.

"All hazard" crop insurance policies, written principally by the Hartford Fire Insurance Company, have been used extensively in the Southeast and South Central states as additional security for crop production loans. These policies guaranteed a fixed money return per acre of crop. If crop returns fell below the insurance per acre, creditors, as beneficiaries of the policy, collected the difference from the insurance company.

This insurance was not intended as price insurance, nor was it necessarily designed to cover the amount invested in the crop. The liability assumed by the insurance company was "not much, if any, more than a good banker would be willing to lend to a highly reputable and skillful farmer."⁹ In fact, after its earliest experiences the insurance company was unwilling to underwrite the entire production loan even if it had been conservatively

⁹ R. M. Bissel (president of the Hartford Fire Insurance Company), "Calamity Insurance," *The Country Gentleman*, Sept. 20, 1924.

made, but required the agricultural credit corporation to share the risk of loss. Loans on sugar cane, fruits, and vegetables were frequently protected by insurance policies which covered from 50 to 75 per cent of the face of the loan. Because of heavy losses the Hartford Fire Insurance Company greatly reduced its liabilities on this

DECLINING IMPORTANCE OF "ALL-HAZARD" CROP INSURANCE*
(In thousands of dollars)

Year	Total	Sugar Cane ^b	Potatoes and Truck Crops ^c	Citrus Trees and Fruit	Peaches, Apples, and Other Fruit ^e	Miscellaneous
1923.....	1,674.2	—	770.1	778.7	125.4	—
1924.....	2,055.2	557.1	594.2	762.9	140.9	—
1925.....	3,655.2	1,386.2	1,468.1	737.8	6.3	56.8
1926.....	2,663.5	425.5	1,207.6	830.8	37.0	160.6
1927.....	1,940.9	57.9 ^d	1,011.1	—	987.7	—
1928.....	1,259.7	—	578.0	1.3	649.3	31.1
1929.....	372.4	—	372.4 ^e	—	—	—

* These figures were furnished by the Southern Department, Hartford Life Insurance Company, Atlanta, Ga., and represent policies written in the Southeast and South Central states.

^b Policies on cane sugar were written almost exclusively in favor of the Intermediate Credit Bank of New Orleans.

^c Approximately 80 per cent of the total liabilities assumed on potatoes and 20 per cent of the liabilities on peaches cover discounts of the Intermediate Credit Bank of Columbia.

^d This figure represents insurance policies written the previous year but cancelled in 1927. The amount is subtracted from the other two items to determine the total liability for the year.

^e Celery.

type of policy after 1925 and discontinued it entirely four years later.¹⁰ The declining importance of "all hazard" crop insurance after the first few years is indicated in the accompanying table, which gives the total liability as-

¹⁰ It might be added that borrowers carried "all hazard" crop insurance only because creditors insisted upon it. Premium rates were too high and the coverage too conservative to make insurance attractive to producers except when funds were not available on other terms.

sumed by the Hartford Fire Insurance Company and its distribution among the several crops.

The indorsement of the marketing agency handling mortgaged crops is another device to strengthen the credit of individual borrowers.¹¹ Co-operative marketing associations and commission houses marketing specialty crops finance their customers through subsidiary credit corporations, but the Intermediate Credit Banks ordinarily require all notes to be indorsed by the marketing agency as well as by the agricultural credit corporation. As a result the credit corporation is relieved of the full responsibility for delinquent accounts and the discounting bank is protected by a second indorsement. If a grower cannot repay his production loan from the proceeds of his crop, the marketing agency may prefer to carry his note rather than to permit the capital of its credit subsidiary to be tied up in uncollectable accounts.

An evaluation of the character of the underlying collateral and indorsements for crop production loans leads to the conclusion that such loans partake of the nature of personal loans in which the integrity of the borrower, his ability as a producer, crop yields, remunerative prices, and the character of marketing arrangements are of major importance. Consequently the question arises whether crop production loans can be made truly self-liquidating.

C. Establishment of Conservative Loan Limits

If production loans are regularly limited to amounts that normally can be liquidated out of crop receipts even in years of low prices and reduced outputs, they may be

¹¹ Landlords are also sometimes required to indorse production notes of their tenants unless the latter have sufficient personal property to protect their loans and can submit a strong financial statement. In any case the landlord is required to waive his prior claim to rent.

properly characterized as liquid loans. Agricultural credit corporations, in their efforts to achieve such liquidity, have used one or more of the following methods: (1) the establishment of a maximum advance per acre for each crop with the understanding that it will be adjusted downward in accordance with an applicant's financial statement and his reputation as a producer; (2) the use of actual data on past yields and estimates of crop receipts in setting loan limits; (3) the use of cost data in determining production requirements which a producer should not exceed if his operations are to be profitable.

A uniform advance per acre modified to meet particular conditions is a simple method for setting loan limits and the one most widely used. If an area of production is reasonably compact and conditions quite uniform throughout, a standard advance may avoid over-lending without working unnecessary hardship upon the more efficient producers. A loan limit of \$20 an acre for rice growers, which was observed by the St. Louis and New Orleans Banks until the low prices of the last two seasons made a more conservative loan basis necessary, prevented advances from exceeding 75 per cent of the estimated income from rough rice during the poorest years and yet represented 50 per cent of the average income during the most profitable season.¹² But when conditions of production and crop yields vary widely over a large area a more precise formula is needed in determining per acre advances.

¹² The average income per acre of rough rice for the five-year period 1926-30 was \$34.07 for Louisiana and \$44.82 for Arkansas. This estimate is based upon data for yield per acre and price per bushel December 1 for rough rice, as given in *Yearbook of Agriculture*, U. S. Department of Agriculture, 1931, p. 664.

Individual production records and annual crop receipts often form the bases of loans by agricultural credit corporations. Records of acreage planted to particular crops, deliveries made in preceding seasons, and incomes received by producers are readily accessible to credit corporations affiliated with co-operative marketing associations. On the basis of such records the Staple Cotton Discount Corporation limits production loans to an amount not greater than 50 per cent of the average annual value of lint cotton (exclusive of seed) produced on the land during the preceding three years, with a provision for a maximum advance of 75 per cent of the lint value of the smallest of the three crops. A similar policy is followed by other credit corporations subsidiary to state-wide cotton co-operatives.¹³

An analysis of cost data in relation to prospective prices enables corporations to eliminate loan applications of high-cost producers whose crop outlays make it unlikely that they can pay out at prevailing prices. Credit corporations financing rice and truck growers have made some use of cost records to good advantage. The Calcasieu Agricultural Credit Corporation, which at one time placed a million dollars of rice loans annually, requires all borrowers to keep records of their crop expenditures. These records are used in setting loans bases for succeeding years and in rejecting applicants whose expenditures appear to be excessive. A few co-operatives marketing specialty crops have compiled data on costs of production which enable them to advise their members in respect to their production programs. Since the marketing associations are often asked to indorse their members' notes, there is an incentive to use any data that will enable them

¹³ Rowe, *The Texas Cotton Growers' Finance Corporation*, pp. 7-8.

to keep advances well within the amount than can normally be paid from crop returns.

Whether rule-of-thumb methods, minimum crop returns, or cost data are used in setting loan limits, the objective is to insure payments of loans from current receipts. However, it is well to note that all credit corporations are not equally concerned with maintaining wide margins of safety on production loans. If their primary object is to increase the sale of supplies, to insure a large volume of raw materials for processing, or to sell the crop on a commission basis, prospective trading profits may encourage a more lenient loan policy.¹⁴

D. Supervision over the Expenditure of Loan Proceeds

A strict control over the disbursement of loan proceeds is another precaution which agricultural credit corporations take to insure themselves against losses. As a part of the loan agreement borrowers promise that loan proceeds will be used exclusively for the production of current crops and the corporation frequently arranges to advance the amount in instalments, as funds are needed, or in accordance with a production budget drawn up at the time the loan is made. The Calcasieu Agricultural Credit Corporation makes all loans upon a budget plan and, to encourage conformity to the budget agreed upon, requires each borrower to keep and submit to the corporation a record of the amount and purpose of each outlay.¹⁵ At the end of every month the credit corporation prepares a statement showing the amount allowed for each

¹⁴ This tendency on the part of certain managements to relax credit standards is discussed in Chap. XIII in connection with the question as to the channels through which Intermediate Credit Bank funds should be made available.

¹⁵ Zimmerman, "Financing the Production of Rice," *American Cooperation*, 1929, p. 491.

item of cost and the borrower's expenditures to date. Subsequent instalments may be withheld if outlays are not in accordance with the agreement or if, at any time previous to the harvest, condition of the crop does not warrant additional investment.

Another method of controlling expenditures is to distribute proceeds in the form of supplies instead of cash. If credit corporations undertake to sell fertilizer, or if they are affiliated with co-operatives operating a supply company, they can easily control the use of at least 50 per cent of the proceeds.¹⁶ Agricultural credit corporations financing specialty crops exercise an even greater control over disbursements, for they are almost invariably affiliated with co-operatives or commission houses that depend upon the sale of supplies as a major source of income. The Wenatchee District Agricultural Credit Corporation credits a member's account with the proceeds of his loan and debits it for all supplies he orders. The Hastings Agricultural Credit Corporation advances from \$100 to \$125 per acre to Florida potato growers, but two-thirds of this amount is in the form of supplies.¹⁷ Since cash advances at harvest time are largely for digging expenses, there is little opportunity to divert them to other purposes, for the amount advanced is checked against the number of barrels delivered to the co-operative. Thus production loans secured by specialty crops are often less hazardous than loans secured by staple crops because expenditures are closely supervised and the portion of the advances designed for harvesting and packing

¹⁶ The Growers' Finance Corporation, Atlanta, Ga., reserves the privilege of reducing the amount of a loan if the applicant does not give the Growers' Supply Company an order for fertilizer equal to half his loan.

¹⁷ Figures were obtained from the records of the Hastings Potato Growers' Association, Hastings, Fla.

expenses can be withheld until crop yields can be accurately estimated.

E. Application of Crop Returns to the Payment of Loans

Since many crops, particularly the staple crops of tobacco and cotton, may be disposed of in small lots and to a variety of purchasers, creditors have difficulty in enforcing their legal claims to crop proceeds. In the absence of an effective collection method, proceeds from mortgaged crops may easily be diverted to other purposes and result in unnecessary renewals. An agricultural credit corporation must either pursue a vigilant collection policy throughout the harvest period, or it must enter into a working arrangement with some marketing agency which can make collections at the source.

As a general rule liquidation is more certain and costs are reduced to a minimum when a co-operative association or a commission firm acts as a collection agent for a credit corporation. Co-operatives face a number of difficulties in such an arrangement, however. Crop mortgages, particularly in the Southeast, are likely to cover several cash crops; but the borrowers may belong to only one marketing association—usually a cotton co-operative which assists in collections. Legally all proceeds from mortgaged crops are applicable to the production notes although the loan may have been primarily for the production of cotton and does not mature until the cotton harvest. Tobacco sales may begin as early as August and legally the proceeds must be applied to the production note. Attempts to enforce legal rights invariably cause friction, however, and the cotton co-operative which hopes to enhance its prestige by arranging for production credit often prefers to overlook the failure to apply

returns from early crops to the indebtedness so long as the cotton crop is apparently sufficient security.

A co-operative may find it advisable to urge the credit corporation as mortgagee to release a portion of the initial advance which the former has made to members at time of delivery. A partial release is often necessary as a matter of business expediency, for borrowers must have funds to cover harvesting expenses and to meet current obligations.¹⁸ Otherwise they will sell outside the association, which complicates collections and means a loss of business for the co-operative. Unless the credit corporation and marketing association can devise a working arrangement which will insure collections without unduly irritating members, co-operatives will be reluctant to serve as collection agents.

Commission houses and co-operatives marketing specialty crops ordinarily can assist in collections without antagonizing producers. Sales are quite prompt so that final settlement can be made without causing an inconvenient delay. Moreover, perishable crops such as fruits, potatoes, and truck products cannot be sold profitably except by those familiar with market outlets, and hence there are fewer opportunities for disgruntled producers to sell outside the regular channels and to misapply proceeds.

The percentage of carry-over loans has been gradually reduced as a result of more careful selection of credit risks, conservative loan bases, and more effective

¹⁸ Some credit corporations affiliated with cotton co-operatives make so-called "harvest loans." These advances are not really loans but the producers are allowed to receive a part of the returns from their crops for harvest expenses before their production loans are paid. Harvest loans range in amount from \$10.00 to \$20.00 on each bale of cotton delivered to the marketing association. See Rowe, *The Texas Cotton Growers' Finance Corporation*, p. 5.

and rigorous collection methods, and because an increasing proportion of the loans originate with credit corporations affiliated with marketing organizations. Discounts outstanding at the close of the year are not entirely satisfactory to show the success of collections because additional liquidation occurs as co-operative associations make final settlement with their members. However, an analysis of collections in the Carolinas and Georgia for 1929 shows a substantial improvement over the first few years when the volume of discounts outstanding in these states at the close of the year ranged from 24 to 43 per cent of all loans placed during the year. In 1929 less than 20 per cent of the discounts for 37 credit corporations making tobacco and cotton loans which were outstanding at the peak of the season remained uncollected at the close of the year. Nine corporations liquidated their accounts in full, 16 had an average of 12 per cent of their accounts outstanding, but the remaining 12 had failed to redeem one-fourth of their discounted paper by the close of the year.¹⁹ If the corporations which are in the process of slow liquidation are omitted, the collection record is more favorable. More than one-third of the amount outstanding represented notes discounted for corporations whose affairs were in such a precarious condition that they made no new loans in 1930.²⁰

¹⁹ Florida corporations rediscounting with the Columbia Bank, all of which finance specialty crops and are affiliated with marketing agencies, liquidated their accounts in full. They were also successful in taking up all their paper in 1930 and 1931.

²⁰ Collections probably improve as a smaller proportion of total discounts is made up of renewals. In 1929, 13 per cent of all discounts in the Columbia District were renewals, but in the New Orleans District all except 2.3 per cent were new loans. Renewals in the Columbia District in 1930 declined to 5 per cent of the total, but in 1931, 21.7 per cent of all discounts in Columbia and 6.7 per cent in New Orleans were renewals.

II. OPERATING LOSSES

The excessive mortality among agricultural credit corporations and the loss ratio of those still in operation clearly demonstrate that the problem of safe management has not been fully solved. Probably the most striking

CAPITAL IMPAIRMENT OF AGRICULTURAL CREDIT CORPORATIONS
COLUMBIA DISTRICT, JUNE 1928^a

Classification (Capital and Surplus) ^b	Number of Corporations	Capital and Surplus	Net Operating Capital	Percentage of Impairment
\$ 10,000- 24,999	29	\$378,300	\$379,400 ^c	—
25,000- 99,999	10	524,000	437,200	10.6
100,000-499,999	4	860,400	444,900	48.3

^a Data were obtained from the Intermediate Credit Bank of Columbia. Later figures are not available.

^b The Growers' Loan and Guaranty Co., Tampa, Fla., has been omitted because it is the only corporation with a capital and surplus of \$500,000 or over and figures for individual corporations are unsatisfactory for our purposes.

^c Undivided profits are included in net operating capital, which explains why this figure exceeds the capital and surplus. A few corporations have added small amounts to their undivided profits accounts.

ing evidence of heavy losses appears in the figures for capital impairment of corporations in the Columbia District which are shown in the accompanying table.²¹ Inasmuch as these estimates are as of June 1928 no corporation has operated more than five seasons and several no more than two or three.

²¹As was explained earlier, examiners from the Intermediate Credit Banks, assisted by local officers, estimate the amount of capital impairment and charge the capital account with all prospective losses. Too much importance cannot be attached to specific figures of impairment since estimated losses may not materialize. A good crop year, accompanied by a vigorous collection policy, may liquidate paper formerly classed as doubtful. However, the history of individual corporations indicates that a large proportion of loans classed as doubtful or worthless do result in substantial losses.

Corporations with capital of less than \$25,000 had suffered no capital impairment, while nearly half of the capital resources of the four largest corporations was tied up in notes receivable of uncertain value if not absolutely worthless.²² It is to be expected that the percentage of impairment for large corporations would exceed that of corporations with paid-in capital of \$10,000 or \$15,000. If the latter are obliged to carry over many doubtful loans, their operating capital is soon reduced below \$10,000 and they become inactive because no longer eligible for discount privileges. Only corporations with substantial resources can afford the luxury of uncollectible accounts and still continue operations.²³

This progressive depletion of capital resources arises from two distinct causes. In the first place conditions in our agricultural and banking industries since 1923 have been such that normal loan operations, especially of corporations placing small cotton and tobacco loans, have resulted in an accumulation of uncollectible accounts even when credit risks were selected with extreme care. Second, hazards more or less external to the loan transactions themselves have involved credit corporations in heavy losses.

²² In fact, two of these corporations had ceased to place new loans by 1930 and were in the process of liquidation; the other two had curtailed their loan operations quite drastically.

²³ See William H. Rowe, *An Analysis of the South Carolina Agricultural Loan Association* (preliminary mimeographed report), Bureau of Agricultural Economics of the U. S. Department of Agriculture, March 1931.

Data on capital impairment are not available for corporations in the St. Louis and New Orleans Districts. However, the short life of many loan associations in the sugar districts of Louisiana and in the cotton areas of Arkansas and Missouri proves conclusively that capital losses are the common experience of a majority of agricultural credit corporations financing growing crops.

Agricultural credit corporations from the very beginning have conducted their loan operations under highly unfavorable conditions. Years of declining prices for agricultural products, combined with low yields owing to boll-weevil infestation, floods, drought, and hailstorms, have left many of their customers hopelessly insolvent, while the unprecedented number of bank failures in rural areas has involved the corporations in severe losses. But losses arising out of the depression in agriculture and demoralized banking conditions are the common experience of all who have financed farm operations. Insurance companies, Federal Land Banks, country banks, and commercial creditors carry frozen or worthless paper that originally appeared on their books as liquid assets with ample margins of safety. Agricultural credit corporations, however, have suffered additional losses because of conditions quite external to individual loan transactions.

Affiliations with other business enterprises have involved many credit corporations in heavy losses. As might be expected, commercial banks, co-operative marketing associations, and private business firms with which credit corporations are closely associated have objectives that may be furthered by an unwise extension of credit as well as by loans that are economically sound. Occasionally these conflicts of interest have encouraged excessively large loans, or have given corporations an adverse selection of credit risks which has left them, after two or three seasons' operations, with an accumulation of uncollectible paper.

Commercial banks which operated credit corporations and found themselves in difficult financial situations transferred past due accounts to the credit corporations

by the simple expedient of approving loans for larger amounts than current crop requirements justified, with the understanding that old accounts were to be reduced. This tendency to sacrifice the credit corporation in the interest of a more liquid portfolio is particularly strong when borrowers furnish the capital investment, since the management has little or nothing to lose and the solvency of the parent bank is at stake. Agricultural credit corporations conducting a state-wide business are usually operated independently of commercial banks, but they often depend upon local banks to recommend loans. Unfortunately these feeder banks have frequently passed on the least desirable loans from their communities and have often been a source of direct loss through failure while holding the proceeds from the sale of crops on deposit.²⁴ To be sure, these experiences do not prove that affiliation with commercial banks is necessarily inadvisable, but only indicate that the weakest banks had the most to gain by utilizing credit corporations, and that their financial interest in the enterprise was not sufficient to prevent the abuse of discount privileges.²⁵

Even the working arrangements between credit corporations and co-operative marketing associations have not always been conducive to the best interests of the

²⁴ Although these banks were not agents of the corporation, and hence a deposit of funds with them did not discharge a borrower's obligation, this fact did not improve the chances of collection. Borrowers had not the wherewithal for a second payment and felt no moral responsibility for the debt, since the bank that negotiated the loan had received payment.

²⁵ Ordinarily these banks were required to indorse paper originating in their territories and to subscribe to stock in the credit corporation equal to 10 per cent of their liabilities. A majority of the banks resold their shares to borrowers and some failed before the stock to which they had subscribed was fully paid. Even though the local bank indorsed the paper, the indorsement of a bank on the verge of insolvency was of no value.

former. When loans are for the purpose of increasing deliveries to marketing agencies, credit standards may be sacrificed in the competition for new business. During the first few years field men of co-operative associations accepted loan applications and made recommendations in regard to them. Too ready acceptance of these reports in lieu of adequate investigation of an applicant's credit status by a competent loan committee was responsible in part for early losses.²⁶

The extent of the losses attributable to adverse production and banking conditions, abnormally low prices, and the conflicts of interests between credit corporations and affiliated business interests cannot be estimated accurately. A number of corporations lost their entire capital investment in one disastrous season or in one bank failure. Dishonesty of officials in a few instances made loss ratios extremely high. But because of differences in allocating expenses and in loan policies loss ratios may be quite misleading. Some corporations affiliated with commission houses or co-operative marketing associations with substantial reserves report no losses because bad debts are shifted to the parent organization. Other corporations operate on a basis so conservative that losses, like their services, are negligible. Others, which attempt to serve all eligible applicants up to the limits of their resources, regularly experience losses and must draw upon current income to provide reserves for bad debts if they are to avoid progressive depletion of their operating capital.

²⁶ The manager of a small North Carolina credit corporation estimates that when field men of the state cotton association made the preliminary investigation the volume of loans placed in his county was twice as large as the volume his corporation is now willing to make after a careful investigation of the applicant's prospects.

How large loss reserves must be to absorb the normal losses arising out of crop loan operations is uncertain. Seasons are too varied, and in most cases the operating experience is too brief, to provide a basis for conclusive judgment. A few corporations have undertaken to set up reserves and have asked borrowers to contribute an amount equal to 1 or 2 per cent of their loans to a reserve fund. However, these percentages have not been based upon operating experience and, since the practice of collecting such an assessment from borrowers has been held by the Farm Loan Board to render the paper ineligible for discount by the Intermediate Credit Banks, they have not been demonstrated to provide adequate reserves over a period of years.

Probably a well-managed credit corporation, doing a reasonable volume of business and fortunately avoiding major disasters, could take care of ordinary losses with a reserve equal to 2 or 3 per cent of its annual volume of loans. The president of the Columbia Bank estimates that a reserve equal to 5 per cent of all loans is needed, and the experience of corporations in this district is evidence that a reserve of this size is not excessive. In contrast to this estimate, B. M. Gile, on the basis of the losses of credit corporations in Arkansas, concludes that a loss reserve of three-tenths of 1 per cent would cover all normal losses from loan operations.²⁷ However, only two of these Arkansas corporations had been in operation since 1924, and the one with the lowest ratio had operated only two seasons. Moreover, Mr. Gile's calculation omits all losses due to malfeasance in office and to bank failures, and to disregard all extraordinary losses

²⁷ B. M. Gile, "Organization and Management of Agricultural Credit Corporations in Arkansas," *Arkansas Agricultural Experiment Station Bulletin No. 259*, January 1931, p. 37.

in determining an annual reserve for losses is to err on the side of optimism. The type of commodity financed, the volume of business handled, and, most important of all, the managerial ability that a corporation can afford to retain will affect the magnitude of the losses but, until operating experience proves that a smaller reserve is adequate over a period of several years, it would appear that agricultural credit corporations operating under reasonably favorable conditions should provide loss reserves equal to at least 2 per cent and preferably 3 per cent of their annual volume of loans.

To recommend the creation of loss reserves implies that incomes are large enough to cover operating costs and to provide for uncollectible paper. But as a matter of fact earnings are not always sufficient even to avoid operating deficits.

III. ADEQUACY OF EARNINGS

The Federal Farm Loan Board, in its efforts to keep interest rates to borrowers low, has narrowly restricted the operating margins allowed on paper discounted by the Intermediate Credit Banks. This policy fails to give sufficient consideration to the risks involved in financing growing crops and the expenses that must be incurred in conducting such a loan business. Operating experience has proved conclusively that many risks cannot be eliminated even with exceptional managerial skill, and the costs of doing business in a manner that will minimize losses are out of all proportion to the interest income allowed to corporations.

Several reasons for the high cost of conducting a crop loan business may be noted. (1) Crop production loans, as shown in the table on page 219, are primarily a small

loan business.²⁸ (2) The annual volume of business of most credit corporations is small and, since crop loans are highly seasonal, the capital funds of credit corporations are used to the maximum advantage for only six or eight months of the year. (3) Risks are concentrated in one industry, and that a depressed one, and their adequate geographical distribution is impossible because of the difficulties of supervision. Even the largest corporations, which obtain considerable regional diversity of risks, must cope with losses from floods, droughts, and insect pests which affect wide areas.

It is apparent from the data in the table that in terms of dollar volume of business the services of agricultural credit corporations are primarily for producers whose annual requirements amount to \$1,000 or more but that, in terms of the number of loans, the bulk of the advances are made to small borrowers. The expense of placing, supervising, and collecting hundreds of small loans explains the high cost of conducting a crop loan business.

Not only are individual loans small but the annual volume of business of the majority of corporations is extremely small. The predominance of corporations handling less than \$100,000 annually is apparent from the table on page 220.

Only three corporations in the Columbia District place \$500,000 of loans annually, but together they are responsible for 35 per cent of all discounts while 27 per cent originate with corporations discounting less than

²⁸ The predominance of small loans does not imply, however, that the services of agricultural credit corporations are readily available to the average small farmer. Most of the advances are in amounts far in excess of the short-term borrowings of the average cotton or tobacco farmer. See "Farm Credit in North Carolina—Its Costs, Risk, and Management," *North Carolina Agricultural Experiment Station Bulletin No. 270*, April 1930.

ADMINISTRATION OF CROP LOANS 219

DISTRIBUTION OF CROP PRODUCTION LOANS ACCORDING TO SIZE*

Crop and Size of Loan	Loans Made		Amount	
	Number	<i>As Per-centage of Total</i>	In Thou-sands of Dollars	<i>As Per-centage of Total</i>
COTTON AND TOBACCO LOANS . . .				
(Southeast) ^b	3,073	100.0	2,756.9	100.0
Less than \$249	603	19.7	91.0	3.3
250-499	894	29.1	301.2	10.9
500-999	805	26.2	514.0	18.6
1,000-1,999	437	14.2	546.3	19.8
2,000-4,999	284	9.2	709.7	25.8
5,000-9,999	39	1.3	249.8	9.1
10,000 and over	11	0.3	344.9	12.5 ^o
RICE LOANS	269	100.0	1,114.9	100.0
1,000 or less	21	7.8	14.9	1.4
1,001-2,500	78	29.0	143.4	12.8
2,501 and over	170	63.2	956.7	85.8
POTATO LOANS	110	100.0	399.9	100.0
Less than \$999	5	4.6	3.2	0.8
1,000-1,999	22	20.0	29.8	7.5
2,000-4,999	59	53.6	193.5	48.4
5,000-9,999	20	18.2	130.4	32.6
10,000 and over	4	3.6	43.0	10.7
CITRUS FRUIT AND APPLE LOANS	264	100.0	843.6	100.0
Less than \$999	107	40.6	50.0	6.0
1,000-1,999	59	22.3	74.9	9.0
2,000-4,999	47	17.8	139.0	16.5
5,000-9,999	27	10.2	187.1	22.0
10,000 and over	24	9.1	392.6	46.5

* Data were obtained from the Intermediate Credit Banks of Columbia and St. Louis and from individual credit corporations. They refer chiefly to loans made during the 1929 crop season.

^b Renewals could not be excluded in every case and so increase the number of small loans; but, even if they were omitted, at least one-third of the cotton and tobacco loans would average less than \$500.

^o These loans are probably peach loans rather than cotton or tobacco loans since a few corporations in Georgia and North Carolina finance peach growers.

\$100,000. Prior to 1931 only two corporations in the St. Louis District handled loans in excess of this amount. In the New Orleans District 83 per cent of all discounts originate with four corporations, each of which has an annual volume of business in excess of half a million dol-

ANNUAL VOLUME OF DISCOUNTS FOR AGRICULTURAL CREDIT CORPORATIONS MAKING CROP PRODUCTION LOANS*

Classification (Discounts outstanding)	Columbia District			New Orleans District			St. Louis District		
	Number of Cor- pora- tions	Discounts (In thou- sands of dollars)	Percentage Distribu- tion of Discounts	Number of Cor- pora- tions	Discounts (In thou- sands of dollars)	Percentage Distribu- tion of Discounts	Number of Cor- pora- tions	Discounts (In thou- sands of dollars)	Percentage Distribu- tion of Discounts
Less than \$50,000.....	12	406.5	7.5	5	161.0	2.0	3	89.1	10.0
50,000-99,000.....	15	1,079.1	20.0	3	209.3	2.6	8	522.9	58.8
100,000-499,000.....	10	2,003.2	37.1	4	942.9	11.9	2	277.1	31.2
500,000-999,000.....	3	1,912.1	35.4	2	1,543.5	19.5	—	—	—
1,000,000 or more.....	—	—	—	2	5,079.9	64.0	—	—	—
Total.....	40	5,400.9	100.0	16	7,936.6	100.0	13	889.1	100.0

* Data were obtained from the Intermediate Credit Banks and are based on discounts outstanding June 30, 1929 for the Columbia District; Sept. 30, 1930 for the New Orleans District; and Aug. 30, 1930 for the St. Louis District. These dates correspond closely to the dates on which the respective districts carried their peak load of borrowings. Discounts outstanding are, of course, somewhat less than total loans outstanding since a few corporations carry small amounts of paper in their own portfolios.

lars. These corporations finance rice growers, sugar planters, and producers of long staple cotton in Mississippi and Arkansas. They not only have a substantial volume of business but their loans are concentrated in compact areas and so permit of more careful supervision at a reasonable cost.

Loans on short staple cotton and on tobacco are distributed over wide areas, and so the costs of supervision and collection are increased. The area which a credit corporation elects to serve and the vigor with which its management solicits loans are determined by the particular objectives of its affiliated business interests. Credit subsidiaries of state-wide cotton co-operatives operate throughout an entire state and sometimes serve a few counties in an adjoining state, while a credit corporation affiliated with a commercial bank makes little effort to develop business outside the immediate community.²⁹ Corporations organized by business interests define their territorial limits in accordance with their trade areas. Even if a credit corporation is independent of other business enterprises, an energetic manager whose salary is dependent upon the adequacy of its operating income may solicit loans over a radius of a hundred miles or more.³⁰

Clearly the crop production loan business, which is inherently seasonal, cannot be conducted upon narrow operating margins, particularly when handled by small corporations placing a modest volume of comparatively small loans over wide areas.

²⁹ Except that a corporation affiliated with a branch banking system serves a much larger loan territory than the immediate locality of a particular branch.

³⁰ See p. 320 for a map showing the size of loan territories in Georgia.

If continuity of loan services is to be assured, more generous interest margins must be allowed. Assuming that production loans have an average maturity of not more than eight months, a 3 per cent spread amounts to 2 per cent annually on the total volume of loans rediscounted. Since operating capital is usually invested in low yield bonds and pledged to secure rediscounts, the credit corporation receives 3 or 4 per cent upon its own capital instead of the prevailing rate for commercial loans. A few credit corporations for a time supplemented their interest income by advancing the proceeds of loans in instalments and withdrawing funds from the Intermediate Credit Banks only as they were needed.³¹ The borrower paid interest on the entire amount for the whole period while the corporation paid only as funds were withdrawn. But the Farm Loan Board regards this practice as a device to enlarge the operating spread beyond the amount authorized, and so has ruled that it makes a corporation's paper ineligible for discount.

A credit corporation rediscounting \$500,000 of loans annually probably would have an operating budget of \$13,000. This calculation is based upon the assumption of a capital investment of \$100,000, a loan ratio of 5 to 1, and an average maturity of eight months for all loans. There is also the assumption that the corporation's revenue is entirely from the 3 per cent operating margin and a 3 per cent yield on the bonds in which its capital is invested. Probably this amount will cover current operating expenses if loans are not too widely distributed and do not involve unusual inspection or collection costs. Possibly a reserve of 1 per cent for losses might be man-

³¹ See Gile, *Arkansas Agricultural Experiment Station Bulletin No. 259*, p. 41.

aged, but certainly no provision could be made for a fair return on capital investment. A corporation placing a similar volume of small cotton and tobacco loans but operating throughout a state, or even within a radius of one or two hundred miles, must employ several field men during the loan season and again at harvest time, in addition to a full-time manager. Unless the services of field men, the credit manager, and the clerical staff, and possibly the overhead expenses, can be shared with another business enterprise, the interest income is insufficient to meet operating expenses and to cover losses on uncollectible accounts even if no unusual losses occur. Corporations may disregard the necessity of setting up reserves for short periods of time but ultimately uncollectible accounts must be charged off against capital and loans curtailed. In the meantime defective accounting creates the illusion that operating costs are being met.

Any figures which purport to show the costs of making production loans are quite unsatisfactory because an accurate allocation of costs to individual loans is impossible. A calculation of the costs of making loans for the Texas Cotton Growers' Finance Corporation places the outlay at 2.87 cents per dollar of loans made.³² But this corporation makes loans averaging \$1,800 in size, and so a comparison of it and a corporation loaning to cotton farmers in the Southeast, where small loans predominate, is not legitimate. Even if costs per dollar of loans could be kept to this figure, an annual interest income of \$13,000 for a corporation placing \$500,000 amounts to only 2.6 per cent on the total volume, which is not sufficient to cover costs. If corporations rediscounting \$500,000 of loans annually are not self-supporting it is

³² Rowe, *The Texas Cotton Growers' Finance Corporation*, p. 30.

obvious that smaller corporations must supplement their interest income in some fashion.

Agricultural credit corporations attempt to meet this problem of inadequate earnings in several ways. (1) They supplement their interest income by sharing with borrowers specific costs incurred in placing their loans; (2) they engage in the retailing of farm supplies; and (3) they proceed on the assumption that they are service organizations, not self-supporting enterprises, and arrange to share their costs of doing business with an affiliated concern.

The Farm Loan Board has ruled that loans are eligible for discount even though credit corporations require borrowers to reimburse them for specific costs incurred in placing their loans. These charges take the form of assessments to cover costs of inspection, examination of court records, clearing of titles, the recording and satisfaction of mortgages.³³ The ways in which these charges are levied vary considerably. Some corporations collect 1 or 2 per cent of the face of the note to cover these costs. Others attempt to assess borrowers for the actual outlays involved in making inspections and preparing and executing the necessary papers. But the more common practice is to charge a flat fee per loan, which varies according to its size. If the latter practice is followed, some borrowers may pay more than the actual costs involved, while others may pay less, but an attempt to assess all costs against particular loans often results in unnecessary hardship. Consequently corporations are allowed some

³³ Until the business practices of applicants are improved and a dependable file of credit information is assembled for those farmers who previously have conformed only to the loose credit requirements of local time merchants, the propriety of including a wide variety of expenses under the heading of "actual costs incurred in placing loans" is not likely to be seriously questioned.

latitude in estimating actual costs, but if they charge excess fees for the purpose of enhancing earnings beyond the 3 per cent operating margin authorized by the Farm Loan Board, the Intermediate Credit Banks will refuse them discount privileges.

An illustration will serve to show how much the actual spread between discount rates and the total direct charges to borrowers exceeds the 3 per cent interest margin which

GROSS COSTS TO BORROWER OF CROP PRODUCTION LOANS
(Based on notes of eight-month maturity)

Size of Loan	Interest for Eight Months at 7 Per Cent ^a	Fees ^b	Net Proceeds	Yearly Rate on Net Proceeds
\$ 250.....	\$11.66	\$ 6.00	\$ 232.34	11.4
500.....	23.34	6.00	470.66	9.4
750.....	35.00	8.00	707.00	9.1
1,000.....	46.65	10.00	943.35	9.0
2,000.....	93.30	20.00	1,886.70	9.0

^a It is assumed that the average maturity of notes is eight months and that the prevailing discount rate is 4 per cent, which allows an interest charge to borrowers of 7 per cent.

^b This schedule of fees was adopted before the operating margin was increased to 3 per cent but there is no reason to assume that fees will be reduced because authorized operating margins are increased.

is now authorized. The fees listed in the accompanying table were imposed in 1929 by a small corporation affiliated with a commercial bank in North Carolina. Since interest and fees were collected in advance, the annual rate is calculated upon the net proceeds of the loan.

Loans of \$250 or less cost the borrower 11.4 per cent annually, while loans in amounts of \$500 and more cost him from 9 to 9.4 per cent. The supplementary charges, together with the interest rate, resulted in a spread of from 5 to 7.4 per cent above the discount rate instead of the 3 per cent margin now authorized by the Farm

Loan Board. This same corporation required borrowers to contribute 10 per cent of their loans to its capital stock, shared its overhead expenses with the commercial bank with which it is affiliated, and retailed fertilizer in order to augment its income.

Other devices to supplement operating margins by sharing expenses with borrowers are less direct, and many have fallen under the ban of the Farm Loan Board. For a time a few corporations collected a percentage of the face of all notes as a reserve for bad debts, sometimes with the understanding that the amount would be refunded if losses did not materialize, but more often without any provision for its return. This practice had to be discontinued if the corporations expected to discount their paper with the Intermediate Credit Banks. One corporation, which requires all borrowers to purchase stock and to deposit it with the corporation as additional collateral for loans, obtains an annual income which has ranged from \$15,000 to \$30,000 from transactions in its own shares of stock. If a borrower wishes to dispose of his stock, thereby surrendering his loan privileges,³⁴ he finds the credit corporation is the only purchaser. Presumably the allowance for surrendered stock bears some relationship to the cost of doing business with the particular shareholder and, if collection costs incurred on his account have been excessive, no allowance is made on the cancelled stock. On the other hand, a customer in good standing, who has consistently met his obligations at maturity, may receive face value for his shares. Uncollectible balances are written off against the par value of the

³⁴ Although ownership of stock may be required, it carries no right to borrow. Each loan application must be approved. Since the stock pays no dividends and carries no *right* to borrow, it has no market and consequently no determinable market value.

stock, and the difference, if any, is transferred to the profit and loss account as "income from repurchased stock."³⁵

Another indirect method of sharing operating costs with borrowers is through the non-payment of dividends on capital stock purchased by them.³⁶ If borrowers subscribe to capital to the amount of 10 per cent or more of their loans and receive no dividends they assume a portion of the costs of operation of the business. On the assumption that a borrower's funds are worth the same price he pays for his loan, a loss of 7 per cent annually on this non-interest-bearing investment should be figured as a cost of his loan. If this item is included in the calculation on page 225, borrowers pay 13.5 per cent for loans of \$250 or less; 10.4 per cent for loans of \$500; and 10.1 per cent for loans of \$1,000 or more.³⁷ But

³⁵ If the expenses of collection are excessive, this arbitrary handling of the capital stock which has been pledged as additional collateral for loans may be entirely justified. However, if the collection of a loss reserve from borrowers makes loans ineligible for discount because it results in a rate higher than the law authorizes, a similar objection can be made to this practice of making profits from stock transactions.

The manager of the corporation defends this policy on the ground that stock penalties eliminate undesirable credit risks, and he points to a steady decline in income from "repurchased" stock as evidence of its disciplinary value.

³⁶ A few corporations, such as the Staple Cotton Discount Corporation and the Wenatchee District Agricultural Credit Corporation, pay dividends on their capital stock, but their managers frankly admit that operating expenses are paid in part by the co-operative association in return for the services rendered to members. The Calcasieu Agricultural Credit Corporation also pays dividends, but again joint costs are shared, this time with the branch banking system with which the corporation is affiliated.

³⁷ Whether a realistic view requires that the entire amount of the capital investment be charged off as a cost of the first loan or that it be allocated over a definite period of years depends upon the success of the corporation in avoiding heavy losses before it has accumulated substantial reserves. If the outlay for stock is considered as a cost of the initial loan, rates for the first loan range from 23 per cent to 28 per cent annually.

even at these rates credit corporations specializing in crop production loans are rarely self-supporting.

Another method of increasing operating income is to sell farm supplies on a commission basis. Agricultural credit corporations may retail fertilizer at a small profit or act as sales representative for fertilizer manufacturers. This is a happy solution of the problem of inadequate income for any corporation that does not compete with local merchants. Sometimes, however, competition with established dealers creates so much ill-will on the part of local business men as to discourage this method of augmenting income.

Since affiliated business interests stand to profit by the extension of production credit to their customers, they frequently are willing to subsidize agricultural credit corporations. Commercial banks, co-operative marketing associations, and business firms engaged either in selling supplies or marketing crops all have operated credit corporations just as they have maintained other service departments that are not worth while if appraised solely by balance-sheet standards.

Commercial banks can well afford the outlay involved in operating agricultural credit corporations provided the seasonal demand for crop loans cannot be met from their own resources and if local producers can safely and profitably utilize more credit than local banks can provide. If outside funds are not available, a bank may be obliged to reduce its secondary reserves to an unwarranted level, or to dispose of profitable earning assets in order to accommodate its regular customers. Whether the maintenance of a credit corporation to bring funds into a community at a time when deposits are being reduced because of outlays for crop-making purposes is

profitable is more than a question of direct returns upon rediscounted paper. The effects of rediscounting upon the annual earnings and general financial position of the affiliated bank should be the deciding factors.³⁸

Co-operative marketing associations sponsor credit corporations because they expect to profit from marketing the crops and from the expenditure of the proceeds of loans. Unless advances to members further marketing programs at a reasonable cost, co-operatives are not disposed to be aggressive in developing a comprehensive loan service. Some co-operative officials, however, believe that control of production credit is indispensable to their success as selling agencies inasmuch as it increases co-operative selling through relieving growers from the supervision of financial institutions or commission houses which are more interested in the profits of their own business than in the promotion of co-operative marketing. The Florida Citrus Exchange estimates that 40 per cent of its 1928-29 tonnage came as a direct result of loans made through its credit subsidiary.³⁹ Clearly, if all retains on this volume of fruit were credited as income to the loan association, the latter would show a handsome profit for the season. Co-operatives handling our staple crops of cotton and tobacco likewise believe that the control of production credits is essential to maintaining deliveries, although less readily identified with monetary gains.⁴⁰

³⁸ Norman J. Wall, "The Gap in Farm Loan Agencies," *American Bankers' Association Journal*, 1931, Vol. XXIV, p. 142.

³⁹ Annual report to the stockholders of the Growers' Loan and Guaranty Company, June 4, 1929.

⁴⁰ This belief is forcibly expressed by W. M. Garrard, general manager of the Staple Cotton Co-operative Association, in "Pertinent Problems in Co-operative Marketing of Cotton," *Journal of Farm Economics*, July 1931, Vol. XIII, pp. 438-39.

So long as producers are unable to sell co-operatively because of the opposition of creditors, co-operative associations have no choice except to supplant existing credit facilities with credit corporations subject to their control. Nevertheless, it is debatable whether production loans increase deliveries enough to justify co-operatives in incurring the expense and risk necessary in order to accommodate even a very small percentage of their members. Various estimates as to the number of members that might qualify for loans were given to the authors but none exceeded 20 per cent of the membership. The percentage of total baleage financed by loans advanced by credit subsidiaries is likewise very small. Only 8 per cent of all the bales delivered in 1927 to the Texas Farm Bureau Cotton Association were financed by its credit corporation.⁴¹ However, neither the percentage of members served nor the number of bales financed is a true measure of success or competent evidence of the demand for the service. Many co-operatives enter the field of production credit largely as a warning to creditor groups not to interfere with the co-operative marketing of crops, but refrain from vigorously developing their loan programs. And the mere fact that co-operatives have access to the Intermediate Credit Banks through their own finance corporations is sometimes effective in persuading creditors not to interfere with the co-operative marketing of the crop.

How much co-operatives can afford to pay for loan services to stabilize or increase deliveries is problematical, and whether an affiliated credit corporation is deemed profitable is largely a matter of accounting. No accurate

⁴¹ Rowe, *The Texas Cotton Growers' Finance Corporation*, p. 16. In 1930 the Texas Farm Bureau Cotton Association was reorganized and now operates under the name of Texas Cotton Co-operative Association.

monetary value can be placed upon its loan services, although they may be considered indispensable in promoting a co-operative marketing program. Nor is the quandary in which co-operatives find themselves always resolved by official advice. The general counsel for the Federal Farm Board warns co-operatives that "credit corporations are an extremely hazardous angle of the financial structure. A co-operative should stay away from them if possible without losing business." But he also points out that if the services of a credit corporation are needed a co-operative can well afford to bear the overhead cost from its own resources.⁴² In short, no working rule is applicable for all. Each co-operative must decide, in the light of local credit facilities available and its own ability to finance members without incurring losses, whether it dares assume the expense of a credit subsidiary as one part of its agricultural program.

Non-co-operative business firms which enter the field of production credit face the same problems which confront the co-operative associations and must weigh the pecuniary costs of supplying loans against any competitive advantages that the control of credit may give them. If a comparatively small volume of loans is contemplated, merchants and manufacturers are disposed to believe that the increased trade does not justify the outlay, but firms advancing several hundred thousand dollars annually find that gross profits are sufficient to warrant the maintenance of a credit corporation. However, unless competitive conditions force business firms to assume more responsibility for financing their own sales or producing their raw materials, they are unlikely to enlarge their lending activities.

⁴² Stanley Reed, "Financial Structure of Co-operatives," *American Co-operation*, 1931, Vol. I, p. 82.

The operating experience of companies handling crop production loans thus far must convince even the most impatient that a rapid expansion of such loans would be an admission that we have learned little from the many failures of credit corporations and are not yet fully aware of the factors which contribute to the limited success of others. Any marked growth in production loans must be accompanied by changes in the organization of local machinery as well as modifications of administrative policies, neither of which can be introduced rapidly. A consideration of necessary changes will be postponed until Part III.

CHAPTER X

LOANS TO CO-OPERATIVE MARKETING ASSOCIATIONS

Such services of the Intermediate Credit system to co-operatives as we have discussed in the previous chapters have all been rendered indirectly through commercial banks or livestock and agricultural credit corporations. The Agricultural Credits Act also authorizes the Intermediate Credit Banks to make advances direct to co-operative marketing associations if warehouse receipts or shipping documents covering non-perishable, readily marketable commodities are pledged as collateral for the loans. It was left to the discretion of the Farm Loan Board to determine the specific commodities acceptable as a basis for such loans.¹ Before discussing the extent to which co-operatives have utilized the Intermediate Credit Banks as a source of marketing credit it is pertinent to examine some of the special problems which confront all banking institutions which undertake to furnish marketing credit for co-operatives.

I. FINANCING COMMODITY LOANS

A great many difficulties and peculiar risks are encountered in making loans to co-operative marketing associa-

¹ A complete list of eligible commodities, however, includes a wide range of products. During 1931 red clover seed, alsike clover seed, and bluegrass seed were added to the list of approved commodities, which already included "cotton, wool, and mohair; wheat, rice, flaxseed, corn and other grains; tobacco; alfalfa, sweet clover, and redtop seeds; beans, including soybeans; canned fruits and vegetables, including cold-pack fruits; raisins, prunes, and other dried fruits; olive oil; extracted honey, maple sirup; broomcorn; sugar (raw and refined); evaporated milk and powdered skim milk; cheese; peanuts and other nuts; and hay." *Annual Report of the Federal Farm Loan Board*, 1931, p. 52.

tions on the security of a wide variety of commodities. In the first place, the way in which co-operatives are organized increases the difficulty of financing them. While these institutions are incorporated legal entities a great majority of them do not have capital stock. As a result the amount of fixed capital invested in their business is very limited and they must borrow on the security of the crop which they are marketing, rather than on their general assets. Many have inadequate working capital and so are extremely dependent upon borrowed funds, and since the size of the advance which they make to members upon delivery of their crops is largely determined by the amount which they themselves can borrow, they are under constant pressure to borrow the maximum amount which creditors will allow.

In the second place, commodities which are to be pledged are not always available in a place or in a form in which they can serve as security for loans. Tobacco and cotton are delivered a few hundred pounds at a time over a period of several months throughout a territory covering hundreds of square miles. Wheat is delivered to hundreds of country elevators which cannot issue receipts that ordinarily are acceptable as security for loans; other commodities must be graded before they can be accurately appraised. And yet cash advances covering some portion of the value of their crops must be made to members at the time the product is delivered at the local receiving stations. Before credit can be extended safely lenders must determine the value of the commodities and satisfy themselves that the warehousing is competent and honest.

The wide variety of commodities handled co-operatively makes it necessary to adapt loan policies to the needs of individual associations. Some commodities are

highly perishable and require particular care in warehousing, or even special warehouse facilities, if loans are to be reasonably safe. Only a few products, chiefly cotton and wheat, are bought and sold on organized exchanges which provide a continuous market and daily price quotations for both spot and future contracts, thus giving a current market value for loan bases. Other commodities, such as tobacco, are sold to a few large manufacturers whose buying policies determine in a large measure the rapidity with which a crop can be sold and loans liquidated. Markets for such crops as dried fruits, canned fruits and vegetables, and cheese are less highly organized than for the major staple crops. Consequently, except for commodities which are dealt in on organized exchanges, the financial responsibility of the association, its sales policy, and general production and market conditions, rather than current price quotations, must determine the terms on which they can be financed.

Other difficulties arise because co-operative marketing associations are comparatively inexperienced agencies and a majority of them have not demonstrated their ability to compete successfully with private agencies in the marketing of farm products. As a result creditors are obliged to concern themselves to an unusual degree with the laws under which the association operates, the marketing contracts under which members deliver their crops, the sales policy of the association, and the character and ability of its management. Unless the co-operative obtains a clear title to the crops members deliver and has a legal right to pledge the commodity of each as security for the loans it negotiates, no banking institution can advance funds safely with the crop as collateral. Creditors must also satisfy themselves that a

sales policy will be followed which will not involve them in financing the speculative withholding of crops. In short it is necessary to make certain that the general conduct of a co-operative's business affairs as well as the collateral pledged warrants the advances requested.

II. THE INTERMEDIATE CREDIT BANKS AND THE CREDIT REQUIREMENTS OF CO-OPERATIVES

The risks inherent in the financing of agricultural commodities as well as the disadvantages of non-stock enterprises have made it difficult for many co-operatives to obtain adequate credit for marketing purposes from commercial banks. The War Finance Corporation advanced large amounts for the marketing of farm products, but a majority of the co-operatives were dependent upon local sources of credit which were often insufficient for their requirements. In the early days of the Intermediate Credit system there was a rather prevalent opinion that co-operative marketing associations would be its chief beneficiaries. The co-operative movement was at that time in a period of vigorous expansion and apparently the Farm Loan Board interpreted the Agricultural Credits Act not only as a mandate to accept such co-operative business as might come to the banks but also as a command to foster the further development of co-operative marketing associations.² However, the Farm Loan Board has made no sustained effort to promote co-operative organizations. In fact, the volume of funds advanced to co-operative associations has been disappointingly small to those who expected the Intermediate Credit Banks to become the primary source of credit for marketing purposes.

² *Annual Report of the Federal Farm Loan Board, 1923, p. 7.* See also address of Merton L. Corey, *Proceedings of the Missouri Bankers' Association, 1923, pp. 67-77.*

The dollar volume of direct loans increased steadily until 1926 but a precipitous decline occurred the following year, reducing the total annual volume by half. Not until 1930, after the Federal Farm Board's program to organize producers co-operatively, did such loans exceed the peak reached in 1926. The table just below indicates the downward trend in dollar volume as well as the declining importance of direct loans in relation to discounts in the period prior to 1930.

LOANS TO CO-OPERATIVE MARKETING ASSOCIATIONS AND
THEIR RELATION TO DISCOUNTS 1923-32
(Figures include original loans and renewals^a)

Calendar Year	Total Loans and Discounts (In thousands of dollars)	Loans		Discounts ^b	
		In Thousands of Dollars	As Percentage of Total Advances	In Thousands of Dollars	As Percentage of Total Advances
1923.....	44,923	35,519	79.2	9,404	20.8
1924.....	117,670	83,223	70.7	34,447	29.3
1925.....	153,251	100,243	65.4	53,008	34.6
1926.....	177,463	103,942	58.6	73,521	41.4
1927.....	138,130	51,009	36.9	87,121	63.1
1928.....	137,170	53,601	39.1	83,569	60.9
1929.....	138,255	43,588	31.5	94,667	68.5
1930.....	218,974	109,927	50.2	109,047	49.8
1931.....	267,994	145,260	54.2	122,733	45.8
1932.....	240,823	89,245	37.1	151,578	62.9
1923-32..	1,634,653	815,557	49.9	819,096	50.1

^a Changes in renewal policies from year to year and the somewhat longer maturities for discounts make a distribution of the total credit extended between direct loans to co-operative marketing associations and advances to financing institutions somewhat misleading. However, the percentages in the table indicate quite clearly the relative importance of the two types of business.

These are revised figures obtained from the Statistical Division of the Federal Farm Loan Bureau, and will not always agree with those published in its annual reports

^b Advances to financing institutions on the security of their own notes payable are included.

Since most of the loans are for the marketing of our major staple crops any change in the credit requirements of co-operatives handling tobacco, cotton, wheat, and wool materially affects their volume. Advances on rice, raisins, and canned fruits are substantial in amount and may be of the greatest importance to the co-operatives concerned, but variations in such commitments do not affect the general trend in commodity loans. (See table.) The increasing importance of loans on the major staple crops during the years 1928-32 is apparent from the table on page 239, while the chart on page 241 gives the distribution by commodities of loans outstanding at the close of each month.

Cotton, wheat, and wool claim the largest portion of commodity loans, accounting for 81 per cent of the total volume in 1932. Although tobacco loans were out of the picture from the fall of 1929 until the spring of 1932, tobacco co-operatives were the heaviest borrowers in the first three years, as is apparent from the chart on page 241.³ Thirty-seven per cent of all loans outstanding December 31, 1925 were secured by tobacco, and 24.5 per cent at the close of 1926; but no new loans were made on tobacco after the 1926 season, and by November 1929 all those outstanding had been liquidated. In May 1932 the Louisville Bank advanced \$244,000 on tobacco, which may mark the revival of substantial commitments to tobacco co-operatives.

³ The Tobacco Growers' Co-operative Association of Virginia, North Carolina, and South Carolina (the Tri-State association) went into receivership in June 1926; the Dark Tobacco Growers' Co-operative Association, Hopkinsville, Ky., ceased to function after the crop year 1926-27; and the Burley Tobacco Growers' Co-operative Association, Lexington, Ky., also liquidated after the 1926-27 season. In the following year only the Maryland Tobacco Growers' Association and the Northern Wisconsin Co-operative Tobacco Pool were active.

LOANS TO CO-OPERATIVE MARKETING ASSOCIATIONS, 1928-32*

Type of Commodity	1928		1929		1930		1931		1932	
	In Thousands of Dollars	Percentage Distribution	In Thousands of Dollars	Percentage Distribution	In Thousands of Dollars	Percentage Distribution	In Thousands of Dollars	Percentage Distribution	In Thousands of Dollars	Percentage Distribution
STAPLE CROPS	28,011	80.5	27,213	83.7	80,670	86.6	123,927	85.3	72,633	81.4
Cotton.....	24,301	69.9	18,337	56.4	53,127	67.0	59,106	40.7	34,147	38.3
Wheat and other grains.....	2,553	7.3	4,605	14.2	15,131	16.2	36,685	25.3	14,025	15.7
Wool and mohair.....	1,157	3.3	4,275	13.1	12,412	13.4	28,136	19.3	24,461	27.4
NON-STAPLES	6,796	19.5	5,402	16.3	12,474	13.4	21,333	14.7	16,612	18.6
Canned fruits and vegetables.....	3,082	8.9	2,097	6.5	3,725	4.0	8,378	5.8	3,588	4.0
Rice.....	1,198	3.4	1,532	4.7	2,553	2.7	2,347	1.6	1,510	1.7
All others.....	2,516	7.2	1,673	5.1	6,196	6.7	10,608	7.3	11,514	12.9
TOTAL	34,807	100.0	32,515	100.0	93,144	100.0	145,260	100.0	89,245	100.0

* Data were obtained from the monthly records compiled by the Federal Farm Loan Bureau. Previous to 1931 only original loans were classified according to the commodity security, but for 1931 and 1932 both originals and renewals are included. Consequently these years are not comparable with earlier years.

Since most of the loans are for the marketing of our major staple crops any change in the credit requirements of co-operatives handling tobacco, cotton, wheat, and wool materially affects their volume. Advances on rice, raisins, and canned fruits are substantial in amount and may be of the greatest importance to the co-operatives concerned, but variations in such commitments do not affect the general trend in commodity loans. (See table.) The increasing importance of loans on the major staple crops during the years 1928-32 is apparent from the table on page 239, while the chart on page 241 gives the distribution by commodities of loans outstanding at the close of each month.

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LOANS TO CO-OPERATIVES

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LOANS TO CO-OPERATIVE MARKETING ASSOCIATIONS, 1928-32*

Type of Commodity	1928		1929		1930		1931		1932	
	In Thou- sands of Dollars	Percentage Distribu- tion	In Thou- sands of Dollars	Percentage Distribu- tion	In Thou- sands of Dollars	Percentage Distribu- tion	In Thou- sands of Dollars	Percentage Distribu- tion	In Thou- sands of Dollars	Percentage Distribu- tion
STAPLE CROPS	28,011	80.5	27,213	83.7	80,670	86.6	123,927	85.3	72,633	81.4
Cotton.....	24,301	69.9	18,337	56.4	53,127	67.0	59,106	40.7	34,147	38.3
Wheat and other grains.....	2,553	7.3	4,605	14.2	15,131	16.2	36,685	25.3	14,025	15.7
Wool and mohair.....	1,157	3.3	4,275	13.1	12,412	13.4	28,136	19.3	24,461	27.4
NON-STAPLES	6,796	19.5	5,402	16.3	12,474	13.4	21,333	14.7	16,612	18.6
Canned fruits and vege- tables.....	3,082	8.9	2,097	6.5	3,725	4.0	8,378	5.8	3,588	4.0
Rice.....	1,198	3.4	1,532	4.7	2,553	2.7	2,347	1.6	1,510	1.7
All others.....	2,516	7.2	1,673	5.1	6,196	6.7	10,608	7.3	11,514	12.9
TOTAL	34,807	100.0	32,515	100.0	93,144	100.0	145,260	100.0	89,245	100.0

* Data were obtained from the monthly records compiled by the Federal Farm Loan Bureau. Previous to 1931 only original loans were classified according to the commodity security, but for 1931 and 1932 both originals and renewals are included. Consequently these years are not comparable with earlier years.

The complete breakdown of co-operative marketing of tobacco in Kentucky and the Southeastern states is probably the most conspicuous single cause of the rapid decline in direct loans after the first few years, although all co-operatives handling staple crops have suffered from irregular and partial deliveries. Not until the passage of the Agricultural Marketing Act of 1929, with its emphasis upon co-operative action and its promise of financial assistance, was general interest in co-operative marketing renewed. In addition to the irregularity of deliveries prior to 1929, declining prices of all farm staples have drastically curtailed the amount of credit which co-operatives require. In the following table no attempt is made to weight these two factors but, taking 1923-24 as the base year, the general downward movement in deliveries prior to 1929 and the persistent decline in prices throughout the period are clearly shown.

DECLINE IN CREDIT REQUIREMENTS OF CO-OPERATIVES*
As Indicated by Indexes of Prices and of Deliveries to Co-operatives, of
Specified Commodities
(1923-24=100)

Crop Year	Cotton		Wheat		Wool		Tobacco ^o Deliveries
	Deliveries	Average Prices	Deliveries	Average Prices	Deliver- ies ^b	Average Prices	
1923-24..	100	100	100	100	100	100	100
1924-25..	121	80	114	138	99	95	61
1925-26..	163	68	69	158	131	99	39
1926-27..	134	44	72	134	134	84	27
1927-28..	91	70	50	130	119	79	3
1928-29..	129	63	61	108	94	94	4
1929-30..	159	59	72	114	175	79	4
1930-31..	260	33	99	72	620	52	7
1931-32..	204 ^d	—	—	—	595 ^d	36	—

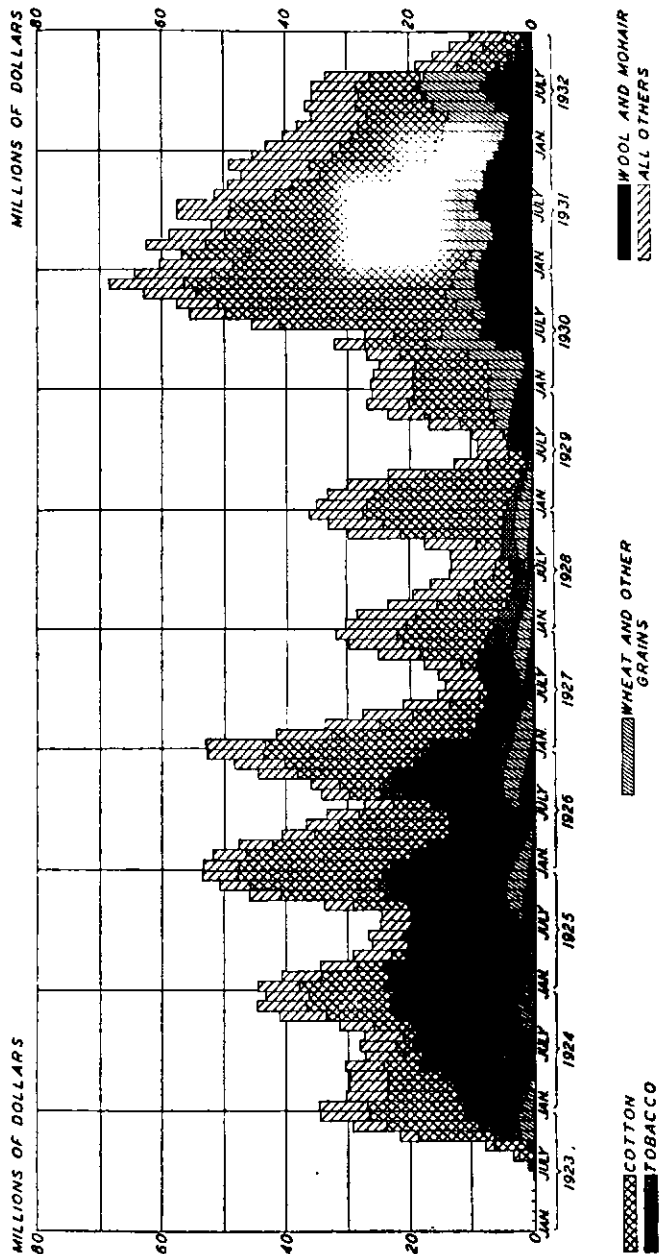
* Data on deliveries to co-operative marketing associations are from *Federal Farm Board Bulletin No. 9*, June 1932. Price data are from the *Yearbook of Agriculture*, U. S. Department of Agriculture, 1932, pp. 670, 812, and 593.

^b The 1923 wool clip and prices are used as base.

^o No satisfactory price data for tobacco are available.

^d Preliminary estimate.

LOANS TO CO-OPERATIVE MARKETING ASSOCIATIONS CLASSIFIED ACCORDING TO COMMODITIES
 Amounts Outstanding at the Close of Each Month, June 1923-December 1932



Now that the Agricultural Marketing Act has definitely committed our country to a policy of co-operative marketing as the basis for a national agricultural program, the co-operative movement, under the direction of the Federal Farm Board, has expanded rapidly. In 1931 wool co-operatives marketed 30 per cent of the wool clip, or approximately seven times the volume of 1923, while deliveries to cotton co-operatives were two and one-half times the number of bales received in 1923-24. With these increased deliveries, loans to co-operatives in 1932 were more than double the amount loaned in 1929 despite the persistent slump in prices.⁴

Circumstances other than fluctuating deliveries and prices affect the volume of loans which co-operatives require. Their annual credit requirements depend also upon the rate of deliveries throughout the season, their sales policy, the amount of initial advance paid to the growers, and the extent to which they are able to finance their own marketing program by means of accumulated reserves or loans from members who do not draw their initial advances. Consequently any concise explanation of either a rise or a decline in volume of loans to co-operative marketing associations is impossible.

Moreover, the Intermediate Credit Banks share with commercial banks the business of supplying the marketing requirements of co-operatives. In fact, some writers interpreted the slump in such loans after 1926 to mean that co-operatives were served adequately by commer-

⁴ It is not within our province to speculate whether this renewed interest in co-operative marketing is permanent. If the business of co-operatives continues to expand, the Intermediate Credit Banks have customers with increased credit needs. Otherwise their opportunities for commodity loans are limited, for they serve no other applicants.

cial banks. In their judgment the demand for commodity loans from the Intermediate Credit Banks is bound to decline as metropolitan banks enlarge their commodity financing through the use of acceptance credits. Others, however, are of the opinion that co-operative associations will continue to need a source of credit that is free from the temporary disturbances of the acceptance market and unaffected by competition with commercial borrowers. An analysis of the extent and character of the competition between commercial banks and the Intermediate Credit Banks for co-operative's business will afford a basis for judging whether the latter may be expected to displace commercial agencies or merely to supplement their services.

III. COMPETITION FOR COMMODITY LOANS

Comprehensive data showing the distribution of borrowings between commercial banks and Intermediate Credit Banks are not readily available, nor are loans from different sources entirely comparable because of differences in maturities. Acceptance credits customarily run for 30, 60, or 90 days; Intermediate Credit Bank loans probably average somewhat less than six months; while loans from local commercial banks are often on demand with actual maturities ranging from a few days to several months. The relative importance to co-operatives of these two sources of credit, as determined by available data, is shown in the table beginning on page 244, where total annual borrowings and loans outstanding at the seasonal peak are grouped separately according to source. Although the particular associations listed may borrow more heavily from the Intermediate Credit

Banks than do co-operatives in general, the data are fairly representative of the distribution of loans.⁵

An interpretation of these data which will account for a particular allocation of loans between the Intermediate Credit Banks and commercial banks, or which will explain shifts from year to year, is extremely difficult. The entrance of the Federal Farm Board into the field of commodity loans in 1929 and the disastrous fall in prices in recent years have resulted in an increased volume of financing by governmental agencies. Broadly speaking, the factors which influence the distribution of loans between commercial banks and the Intermediate Credit Banks are the credit status of the individual co-operatives, the personal preferences of their management, the existence of active competition for commodity loans, and certain competitive advantages of commercial banks

SOURCES OF FUNDS BORROWED BY CO-OPERATIVE MARKETING ASSOCIATIONS
I. Percentage Distribution of Total Annual Borrowings of Two
Cotton Co-operatives
 (Data are for crop years)

Borrower and Lender	1923-24	1924-25	1925-26	1926-27	1927-28	1928-29
A. Texas Farm Bureau Cotton Growers' Association:^a						
Intermediate Credit Bank	...	8	20	15	6	...
Local Texas banks	...	51	61	54	65	...
New York syndicate	...	41	19	31	29	...
B. Arkansas Cotton Growers' Co-operative Association:^b						
St. Louis Intermediate Credit Bank	25	18	32	76	86	23
Commercial banks	70	68	43	22	12	76
Bankers' acceptances	—	7	22	—	—	—
Other sources	5	7	3	2	2	1

^a In this table no attempt has been made to weight the amount of borrowings in accordance with the maturities of the paper. Since loans of different maturities cannot be substituted for one another, any system of weights is unsatisfactory.

II. Percentage Distribution of Amounts Outstanding at Seasonal Peaks,
for Specified Co-operatives
(Data for cotton and tobacco loans are for December 31; for wheat,
October 31)

Borrower and Lender	1923	1924	1925	1926	1927	1928	1929	1930	1931
A. Staple Cotton Growers' Association:^a									
Intermediate Credit Bank.....			93	87	50	54	37	47	41
Commercial banks.....			—	9	40	39	27	19	12
Federal Farm Board.....			—	—	—	—	27	34	47
All other sources.....			7	4	10	7	9	—	—
B. Another Cotton Growers' Association:^d									
Intermediate Credit Bank.....				88	61	72	—		
Commercial banks.....				—	—	2	95		
Federal Farm Board.....				—	—	—	5		
All other sources.....				12	39	26	—		
C. Burley Tobacco Growers' Co-operative Association:^e									
Intermediate Credit Bank.....	—	56	56	78	—	—	—	—	—
All other sources.....	100	44	44	22	—	—	—	—	—
D. Darki Tobacco Growers' Association:^e									
Intermediate Credit Bank.....	57	62	60	76	100	100	—	—	—
All other sources ^f	43	38	40	24	—	—	—	—	—
E. A Wheat Growers' Association:^d									
Intermediate Credit Bank.....				78	57	63	82	53	...
Commercial banks.....		100	100	22	43	37	8	42	...
All other sources ^g				—	—	—	10	5	...

^a Data are from R. H. Montgomery, *The Co-operative Pattern in Cotton*, pp. 183-84. The name of this association is now Texas Cotton Co-operative Association.

^b Data are from *Arkansas Agricultural Experiment Station Bulletin No. 245*, December 1929. In 1930 this association was consolidated with two others to form the Mid-South Cotton Growers' Association.

^c Data are from financial statements of the association published in *Staple Cotton Review*.

^d Data were obtained directly from the association but without permission to use its name.

^e Data are from an unpublished manuscript by E. C. Johnson.

^f Primarily from the War Finance Corporation.

^g From the Farmers' National Grain Corporation and the Federal Farm Board.

which lead co-operatives to prefer commercial loans if they are available.

A limited number of co-operatives which have demon-

strated their business ability over a period of years find it easy to finance more and more of their requirements through commercial sources. Local bankers who have confidence in the ability and integrity of the management are willing and often anxious to loan their surplus funds to co-operative associations. A few co-operatives whose annual credit requirements run into several million dollars command the confidence of metropolitan banks and receive advantageous terms for lines of credit equal to a substantial portion of their requirements.⁶

Prior to the efforts of the Farm Board to strengthen the co-operative movement many metropolitan banks withdrew from the financing of co-operative associations because of a growing distrust in the ultimate success of these marketing ventures. But some co-operatives which at one time were wholly dependent upon the Intermediate Credit Banks have succeeded in establishing lines of credit with local banks and are gradually transferring a portion of their business to them.⁷

Personal differences between co-operative managers and officers of an Intermediate Credit Bank occasionally lead to a transfer of accounts without much regard to the comparative cost of funds, the character of the service, or convenience. In short, co-operatives, if their credit status allows them any freedom of choice, distribute their borrowings among several banks and change their

⁶The Wyoming Wool Growers' Association has had extensive lines of credit with New York banks. The National Wool Marketing Association, set up under the auspices of the Federal Farm Board, at first divided its borrowings about equally between the Intermediate Credit Banks and commercial banks, but in 1932 it used the Intermediate Credit Banks exclusively.

⁷71 Cong. 1 sess., *Farm Relief Legislation*, Hearings before Senate Committee on Agriculture and Forestry, Mar. 25 to Apr. 12, 1929, p. 647. (Testimony of George E. Duis, president of the North Dakota Wheat Growers' Association, Grand Forks.)

banking connections for the same reasons or whims as do grain dealers, cotton brokerage firms, packers, or any other business firms.

Active and effective competition between commercial banks and the Intermediate Credit Banks does not always occur. The Intermediate Credit Banks have been effectively prevented from competing for business by legal restrictions and administrative policies. So long as the Intermediate Credit Banks were required to make loans with minimum maturities of six months they were at a disadvantage in handling loans—particularly for wheat and wool co-operatives, which frequently wanted advances for a few weeks only.⁸ If a co-operative wished to take up its note before maturity it could do so, but the Intermediate Credit Bank reserved the privilege of collecting a charge sufficient to reimburse itself for any losses on outstanding debentures which it had issued upon the assumption that funds would be needed for a longer period. To be sure, this option was rarely exercised and in practice co-operatives were usually free to take up their paper at their own convenience without penalty charges.

Now that the minimum maturity has been eliminated, the Intermediate Credit Banks are free to compete for all the business of co-operatives. What effect, if any, this change will have is unknown. It may cut into the business of metropolitan banks if their rates do not compare favorably with those of the Intermediate Credit Banks, but local banks are less likely to be affected since

⁸ Even the average maturity for cotton paper in most seasons falls below the six-month minimum. An analysis of the maturities of loans to the North Carolina Cotton Growers' Association for the five-year period 1924-29 shows that in only one year did the average maturity exceed six months.

convenience and personal considerations rather than interest rates are often the deciding factors. In any case the removal of this restriction presumably sanctions competition for all maturities and may bring added pressure upon interest rates if the Intermediate Credit Banks actively solicit business.

Such competition, however, presupposes a change in the official attitude as to the proper role of the Intermediate Credit Banks. In the beginning co-operatives were constantly reminded that the Intermediate Credit Banks were expected to supplement commercial lines of credit and that they (the co-operatives) should not allow small differences in interest costs to influence their distribution of loans. As a result many co-operatives regarded their lines of credit with Intermediate Credit Banks as facilities to be used only in emergencies or in case commercial banks desired to shift their risks before an association had disposed of its crop. By adhering to this policy of "standing by" rather than actively soliciting accounts, the Intermediate Credit Banks have undoubtedly lost business to commercial banks whenever the latter were disposed to increase their commodity financing.

But commercial banks are not always active bidders for co-operative business—even when the credit standing of the applicant is excellent. The decision of commercial banks to finance any particular crop or association is made in the light of prevailing conditions. No permanent customer relationship is built up, and because loans are made one season no presumption is created concerning accommodation for following seasons.⁹

⁹ George R. Wicker, "Conference on Finance Problems," *American Co-operation*, 1925, Vol. I, p. 436.

Production conditions and the prevailing money market situation determine the volume of commodity financing commercial banks undertake. In years when the quality of crops is poor and prices are unsettled the Intermediate Credit Banks are expected to carry a heavier share. In 1926, when the cotton crop was not only exceptionally large but of very low quality, co-operatives had difficulty in disposing of their holdings. Many commercial banks preferred to withdraw from the field, leaving the Intermediate Credit Banks to finance any inter-seasonal carry-over that might materialize. Money market conditions also explain the withdrawal of commercial banks from active competition for commodity loans. In 1928 and 1929, when call loan rates were extremely attractive and other business and commercial outlets more profitable, commercial banks (especially those in the larger centers) were less interested in co-operative business. But in 1924 and again in 1930, when business demands slackened and easy credit conditions prevailed, co-operative loans were solicited eagerly by commercial banks, at attractive rates. But their willingness to loan at less than their usual rates is often in direct proportion to the certainty that loans can be readily transferred to the Intermediate Credit Banks if more profitable business becomes available.¹⁰

Even if the official attitude changes and the Intermediate Credit Banks pursue a more vigorous policy in soliciting business, they have yet to convince co-operatives of their superiority to commercial banks as a source

¹⁰ An officer of the Georgia Cotton Growers' Association says that they can obtain accommodation at Atlanta banks for short periods at low rates but with the understanding that these loans will be retired when the banks have more attractive opportunities for their funds.

of loans. The relative advantages of commercial bank and Intermediate Credit Bank services are carefully considered by co-operatives, especially with regard to cost of funds, margin requirements, and flexibility in handling collateral so as to interfere least with the movement of commodities into channels of distribution.

In a comparison of interest charges the advantage normally lies with the Intermediate Credit Banks. However, in periods either of extreme ease in the open money market or of credit stringency, acceptance credits can compete successfully with Intermediate Credit Bank loans on a price basis. Even after allowing for the customary 1 per cent per annum commission charge for 90-day maturities, commercial banks in 1930 and 1931, except for very short periods, could accommodate customers by means of acceptance credits at more favorable rates than could the Intermediate Credit Banks.¹¹ Although more than half of the debentures issued in 1930 carried rates of 3 per cent, the average for the year was 3.35 per cent. During 1931 it dropped to 3.27 per cent, which was still well above the average rate of 1.58 per cent for 90-day prime bankers' acceptances for 1931.¹² Even if the Intermediate Credit Banks can afford to operate on less than their legal margin of 1 per cent, commercial banks can meet their competition on a price basis whenever money is extremely plentiful because the acceptance market is more sensitive to change than the short-term investment market.

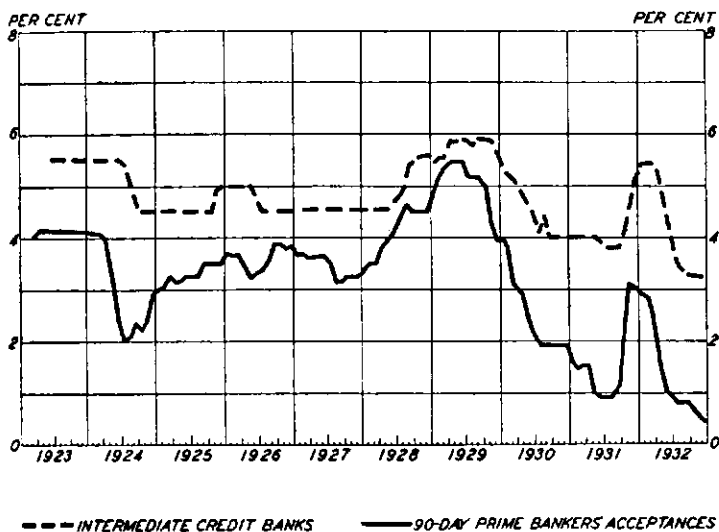
The Intermediate Credit Banks are also at a disad-

¹¹ The Intermediate Credit Banks were not authorized to create acceptances until the amendment of May 19, 1932.

¹² Debentures were sold to yield 3.38 per cent in 1930 and 3 per cent in 1931, which is somewhat more than the nominal interest rate. See table on p. 296 for average rates on debentures.

vantage during a credit stringency. Short-term investment rates tighten promptly and debentures must be sold to yield higher returns. If the Federal Reserve system follows its customary practice of keeping the buying rate on acceptances low in order to protect ag-

AVERAGE RATES ON BANKERS' ACCEPTANCES AT NEW YORK
AND ON LOANS OF INTERMEDIATE CREDIT BANKS
COMPARED, 1923-32^a



^a The average loan rate for the Intermediate Credit Banks was computed by weighting the rate for each bank by the volume of loans to co-operatives outstanding at the close of each month.

riculture and industry against an undue tightening of the money market, commercial banks can offer more attractive rates than the Intermediate Credit Banks.¹³

¹³ Now that the Intermediate Credit Banks are authorized to create acceptances by the amendment of May 19, 1932, they can take advantage of the lower rates made possible by this credit policy. But it is too early to judge whether the banks will avail themselves of the privilege of creating acceptances.

This second contingency, however, is less likely to result in an increase of commodity loans, since commercial banks find call loans more attractive or feel that their first responsibility is to their regular customers and not to the "in-and-out" business of co-operatives. The chart on page 251 compares the average loan rate of the Intermediate Credit Banks with the average rate on 90-day prime bankers' acceptances in New York City. The spread between them, except from 1928 to the middle of 1929, is sufficient to allow for the usual commission charge on acceptances.

Loans from commercial banks other than acceptance credits usually carry rates above those of the Intermediate Credit Banks. If business demands are slack, local banks may make price concessions to co-operatives, but ordinarily their rates are quite inflexible at 5 and 6 per cent. As we mentioned earlier, however, this willingness of commercial banks to place otherwise idle funds temporarily at low rates does not commit them to a permanent responsibility for accommodating co-operatives at rates below the prevailing level.

Differences in interest costs are seldom the determining factor in the allocation of loans. Interest data for the wheat pool, whose distribution of loans at the seasonal peak is given in the table on page 245, give little evidence that differences in rates determine the distribution of borrowings. Even when the Intermediate Credit Bank rate was 1 per cent below the rate on commercial bank loans this association borrowed 42 per cent of its requirements from commercial sources. Similar data for the Texas Farm Bureau Cotton Growers' Association for the period 1924-28 indicate that the somewhat lower cost of funds from the Houston Intermediate

Credit Bank did not encourage the association to borrow more than a small portion of its total requirements from this source.¹⁴

Nominal interest rates do not always afford a proper basis for comparing costs of loans, especially for co-operative associations whose annual requirements or uncertain credit standing does not give them ready access to the New York money market. Additional expenses often raise the costs of Intermediate Credit Bank funds to a level equal to or even above commercial rates. The most frequent types of supplementary charges are custodian fees and charges which arise where special precautionary measures are essential to protect the creditor bank.

A custodian or trustee bank is indispensable whenever the lending bank and the co-operative association are located in different cities. The custodian holds the collateral documents, releases them after loans are paid, or makes substitution of collateral whenever necessary to facilitate marketing of the commodity. Local banks may act as custodian for their city correspondents without charge, but they normally charge a fee when acting for the Intermediate Credit Banks. Since the co-operative pays for this service the lower rate of the Intermediate Credit Bank is offset to this extent.

Frequently a co-operative must incur additional expenses to make its collateral instruments acceptable to the Intermediate Credit Bank. Since the entire security for loans is the commodity pledged, creditor banks must assure themselves that commodities are honestly warehoused and remain so throughout the period of the loan. But if an association uses a state-licensed warehouse,

¹⁴ See R. H. Montgomery, *The Co-operative Pattern in Cotton*, p. 184.

where inspection is often perfunctory and the financial responsibility of the owner insufficient for adequate protection, the Intermediate Credit Bank investigates the management, the character of the supervision exercised by the state, and the financial condition of the warehouseman—all at the expense of the co-operative. In addition, the bank may ask the co-operative to give surety bonds covering faithful performance of duty by the warehouseman.

Depository banks handling remittances and custodians responsible for collateral documents may also be required to furnish bonds of faithful performance. The bonding of depository banks is particularly important since excessive bank failures introduce a serious risk of loss through deposits impounded in closed banks. These additional charges materially increase the cost of Intermediate Credit Bank loans. A wheat co-operative, which at the time was wholly dependent upon the Intermediate Credit Bank for credit, submitted a memorandum to the Federal Farm Loan Board in 1925 purporting to show that supplementary charges increased their interest rate by 2.02 per cent. This brought the cost of loans well above the rates for commercial loans.

These additional charges, which partially offset the more favorable interest rates of the Intermediate Credit Banks, are not usually imposed by commercial banks. Local banks may even accept as collateral warehouse receipts that cannot meet the standards demanded either by New York banks or by the Intermediate Credit Banks. Since their interest rates are higher, commercial banks can afford to assume greater risks, and they often prefer to absorb certain costs rather than particularize all items of expense and assess them directly against the

borrower. However, in general it is safe to assume that, on the basis of similar security and under normal conditions in the money market, co-operatives secure accommodations with the Intermediate Credit Banks at somewhat lower rates than with commercial banks.¹⁵ In those instances in which special outlays are necessary to safeguard the Intermediate Credit Bank against losses it is very doubtful whether New York banks would extend a line of credit. A comparison of total costs for funds is legitimate only if similar credit risks are incurred.

Commercial banks offer more serious competition through the terms granted on loans and the character of their service than through interest rates. The latitude of commercial banks in determining loan margins gives them a particular advantage. The Intermediate Credit Banks are limited by law to advances not in excess of 75 per cent of the market value of commodities, but they have kept loans well below this legal maximum. Advances of 60 per cent on the market value of wool, 65 per cent on cotton, and 70 per cent on wheat represent the customary loans on staple products that are bought and sold on organized commodity exchanges. Occasionally loans on wheat reach the legal maximum of 75 per cent, but advances of 70 per cent are customary.

In addition to substantial margins loan agreements usually provide that in no case shall advances exceed a stipulated maximum per unit of the commodity. In 1929 the Intermediate Credit Bank of Omaha advanced 60

¹⁵ As we have noted earlier (p. 251) an exception to this general conclusion is necessary during periods when acceptance rates are kept at artificially low levels by Federal Reserve policy. Since debentures are sold in the open investment market, their rates are immediately affected by a tightening money market.

per cent of a fair market value of warehoused wool, but in no case was the advance to exceed 25 cents per pound; in 1930 it loaned 75 per cent of the value of wheat with a maximum advance of 80 cents per bushel for No. 1 Northern wheat, with appropriate maxima for other grades. By establishing a maximum loan value the Intermediate Credit Banks limit their advances in a rising market to a point considerably below the legal maximum based upon current market quotations.¹⁶ Thus as a matter of banking policy as well as of law they are required to adhere to a conservative schedule of advances.

Commercial banks are free to give more liberal advances if market conditions warrant. Since most commercial banks expect to finance co-operatives at the peak of the season when sales are relatively easy, but do not intend to finance inter-seasonal requirements, narrower margins on loans are justifiable.¹⁷ Furthermore, these banks sometimes loan as high as 90 or even 95 per cent of the market value of commodities which are hedged in the futures market.¹⁸

But commercial banks are not always content with

¹⁶ The value of a product is calculated on the basis of spot quotations in a particular terminal market minus freight, storage, handling, and insurance charges. For instance, wool prices are based on Boston quotations; the basing points for wheat usually are Minneapolis, Omaha, or Chicago.

¹⁷ A credit agreement of the Texas Farm Bureau Cotton Association with a New York syndicate allowed a maximum of outstanding acceptances of 10 million dollars up to February 1. Between February 1 and May 1 the amount was not to exceed 7 million dollars and was to be reduced to 3 million by the latter date. All loans were to be liquidated by July 1. Montgomery, *The Co-operative Pattern in Cotton*, Chap. VII.

¹⁸ The manager of a wheat co-operative writes that, prior to the 1930 crop, commercial banks in wheat terminal markets regularly advanced 85 to 90 per cent of the value of stored wheat, and at times loaned 95 per cent of its value for short periods.

narrower margins than the Intermediate Credit Banks require. A schedule of advances from a New York syndicate in a loan agreement with the Texas Farm Bureau Cotton Association called for a margin of 40 per cent on unhedged cotton when prices were judged to be high (25 cents per pound), but only 30 per cent when the price fell to 20 cents a pound.¹⁹ This schedule, as well as the testimony of other New York bankers, warrants the conclusion that margins of 30 and 35 per cent on unhedged cotton are customary. Such margins are in line with those maintained by the Intermediate Credit Banks.

The conservative advances of the Intermediate Credit Banks often make it necessary for co-operatives to restrict their initial payments to members. As a result they are frequently placed at a disadvantage in competing with commercial buyers. At the time that commercial agencies were offering to accept Wyoming wool on consignment and to advance the shipper from 28 to 30 cents a pound, the Wyoming Wool Growers' Co-operative Association could advance only 24.5 cents, since this represented the maximum it could borrow from the Intermediate Credit Bank on stored wool.²⁰ Cotton and wheat co-operatives experience similar difficulty in obtaining deliveries whenever their initial advances to members are so low as to make offers from commercial buyers a constant temptation to sell outside the association. Impecunious members may find that co-operation is literally impossible. Although co-operatives do not find it necessary to borrow up to the maximum on their stored products throughout the season, there are short

¹⁹ Montgomery, *The Co-operative Pattern in Cotton*, pp. 181-82.

²⁰ It should be noted that this advance was only slightly more than 60 per cent of the market value of wool based upon Boston spot prices minus such expenses as transportation and handling charges.

periods when they must borrow up to the limit. At these times the more liberal advances of commercial banks are extremely attractive.

Amendments to the Agricultural Credits Act have been proposed to permit advances in excess of 75 per cent of current market values. But the United States Treasury, which contributes the capital for the Intermediate Credit Banks, opposes any suggestion to reduce the margin on commodity loans. Recently when a bill eliminating the provision concerning maximum advances was being considered by the Senate Committee on Banking and Currency, Secretary Mellon disapproved of the change on the ground that the only advantage would be to allow larger advances which might injure the investment standing of Intermediate Credit Bank debentures.²¹

Since the suggested amendments leave the amount of particular advances to the discretion of the Farm Loan Board and the Intermediate Credit Bank making the loan, a change of law would not necessarily mean a reduction of margins. Conceivably the removal of a legal maximum might result in larger advances to strong co-operatives dealing in cotton and wheat. But it seems to be the general opinion of metropolitan bankers that under normal credit conditions the Intermediate Credit Banks accommodate co-operatives on as satisfactory terms as they are willing to grant except for a few superior credit risks. However, commercial banks do have a competitive advantage in financing a few of the most successful co-operatives handling the staple crops of wheat, cotton, and wool, which are bought and sold on

²¹ 71 Cong. 2 sess., *Amendments to Federal Farm Loan Act*, Hearings before Senate Committee on Banking and Currency, Apr. 8, 1930, p. 17.

organized exchanges and which can be protected by hedges in the futures markets.²²

In the case of commodities that are not dealt in on organized exchanges, very little if any difference exists between commercial banks and the Intermediate Credit Banks in regard to loan margins. The Tri-State Tobacco Growers' Co-operative Association borrowed from Baltimore, Richmond, Pittsburgh, and New York banks as well as from the War Finance Corporation and later the Intermediate Credit Bank of Baltimore, but there is no evidence that commercial banks were more lenient in their terms than the Intermediate Credit Banks. In fact the former protected themselves against non-liquid paper by arranging that the Intermediate Credit Bank of Baltimore would take over the loans and finance such tobacco as could not be disposed of immediately.²³

Loans on non-staple specialty crops require much wider margins than staple commodities. Here again commercial banks display the same conservatism in making advances as do the Intermediate Credit Banks. In 1930, when the Federal Farm Board arranged for a 3-cent per pound advance to the Sun Maid Raisin Growers on certain varieties of raisins, the Berkeley Intermediate Credit Bank participated on the same basis as commercial banks. The regularity with which certain commodity groups use the Intermediate Credit Banks, the gradual extension of the list of eligible commodities, and the consistent increase in dollar volume of loans on

²² As yet the New York wool futures market is not developed to a point where it affords a satisfactory protection. Hence in the financing of wool, commercial banks often evince the same conservatism in margins as characterizes the Intermediate Credit Banks.

²³ John J. Scanlan, "Business Analysis of the Tobacco Growers' Co-operative Association," *U. S. Department of Agriculture Circular No. 100*, October 1929, p. 81.

miscellaneous products all suggest that the Intermediate Credit Banks offer dependable loan services on terms that are not available elsewhere. Commercial banks are no more willing to loan on narrow margins than are the Intermediate Credit Banks if market outlets are uncertain, over-production is imminent, or prices are fluctuating rapidly.

Preference for commercial loans is based upon claims of convenience as well as upon the advantage of smaller margins. "Too much red tape" and "unnecessary technicalities" are blanket terms used to express dissatisfaction with certain features of the Intermediate Credit Banks services. Broadly speaking these criticisms are directed against three things: (1) the time-consuming process of preparing loan applications and accompanying exhibits and the vexatious delays in obtaining final approval of applications; (2) the amount of paper work necessary to describe and account for collateral pledged; and (3) the technical requirements which interfere with the movement of commodities through the channels of trade. A few examples will serve to show the validity of these criticisms; the efforts of the Intermediate Credit Banks to remove any legitimate causes for complaint; and any net competitive advantages which commercial banks may gain because of these annoyances.

Each loan season the co-operative must file an application for advances and support this application by special exhibits and schedules. Even if the co-operative has been served for several years it is required to file documents attesting to the right of officers to borrow funds and to pledge commodities as collateral, a schedule listing the warehouses to be used and statements in regard to their financial position, and a financial statement of

the co-operative association.²⁴ If the co-operative is applying for its first loan it must also file copies of its articles of incorporation and by-laws; a copy of the marketing agreement; and copies of the form of notes, drafts, and custodian's receipts which are to be used.

Loan negotiations with commercial banks are ordinarily less formidable as far as documentary evidence is concerned. Officers of such banks must satisfy themselves, through interviews or otherwise, as to the integrity and ability of the management and the adequacy of the security offered; but legal technicalities can be waived if they do not contribute to these basic requirements.

The loan procedure of the Intermediate Credit Banks undoubtedly is becoming less complicated. After some degree of standardization has been achieved in the business and financial set-up of co-operatives and in their membership contracts, conformance with legal technicalities will be simplified.²⁵ Officers of the Intermediate Credit Banks admit that there has been a tendency to require new exhibits each year when a certification of change would be sufficient; and that, because the system is centralized at Washington, additional copies of all documents are required.²⁶ As permanent customer relationships are established the filing of numerous documents can be minimized, but reports to Washington can-

²⁴ See Appendix B for the form of loan application used in the Berkeley District.

²⁵ The Intermediate Credit Banks insist that much of the burden of preparing these papers falls upon them. The co-operative officials only examine them and supply the necessary signatures.

²⁶ From four to seven copies of certain documents may be required. Copies must be filed at Washington, with the Registrar of the Federal Land Bank, with the Intermediate Credit Bank, with the co-operative association, and with the custodian bank.

not be avoided so long as the Farm Loan Board takes an active part in passing on applications. To the extent that strict conformity to legal forms and conservative loan policies are essential to safeguard the credit of the Intermediate Credit Banks in the investment market and hence contribute to the lower rates, the inconvenience of so-called "red tape" is the price of this saving.

Approval of loan applications can be hastened if final decisions are left to the Intermediate Credit Banks. Previous to September 1930 applications for commodity loans were submitted to the Farm Loan Board for approval if the amount involved was more than \$100,000. At present applications are not submitted to Washington except:

1. When the commodity upon which the proposed loan or advance is based is one not previously approved by the Board as a staple agricultural product eligible for collateral purpose;
2. When the amount applied for equals or exceeds the amount of the banks' authorized capital, that is, 5 million dollars.

Subject to these limitations and provisions of the Act of 1923, the banks are authorized to make loans to eligible co-operative associations after satisfying themselves as to the eligibility, set-up, financial conditions, management, and marketing program of the applicant, as well as the character and quality of the commodities to be offered and the conditions under which they are warehoused.²⁷ This partial withdrawal of the Farm Loan Board from active participation in approving loans undoubtedly will expedite final action on them. But since large co-operatives normally require lines of credit in ex-

²⁷ *Federal Farm Loan Bureau Release No. 79*, Sept. 4, 1930. (A mimeographed circular sent to Intermediate Credit Banks.)

cess of 5 million dollars, this change will not affect them. There is some justification, however, for retaining central supervision of loans if commitments to one association exceed the authorized capital of individual banks since the twelve banks are jointly responsible for all outstanding debentures.

A more serious irritant to co-operatives has been the tedious reports listing and describing all collateral pledged to secure loans. In the beginning a cotton co-operative was asked to list all bales pledged, the staple and grade of each, and its value f.o.b. a designated delivery point. Commercial banks were satisfied with periodic reports enabling them to check up at intervals as to the sufficiency and quality of the commodity pledged. After a little experience in commodity financing, the Intermediate Credit Banks adopted a similar procedure.²⁸

Difficulties experienced in securing release of collateral as commodities are sold and shipments made are the source of a third criticism. Collateral documents such as bills of lading and warehouse receipts are indis-

²⁸ Now a semi-monthly statement of deliveries reporting the class, staple, and weight of the bales pledged is sufficient. The loan value is computed on the basis of spot prices for that day on the grades and staples reported. The average value for cotton delivered during one two-week period provides the loan basis for the succeeding two weeks, after which another determination is made. If the cotton becomes less satisfactory as the delivery season advances, or as the better grades and staples are sold and inferior cotton is substituted, loans are adjusted in accordance with the lower market value. In this way the Intermediate Credit Bank is protected against over-lending while the custodian of collateral documents is relieved of reports that are not essential to safeguarding the loan.

Co-operatives now complain that the Federal Farm Board requires the same laborious reports in connection with its supplementary advances. One officer commented that evidently the experience of the Intermediate Credit Banks had not taught government bodies much about commodity financing.

pensable for the movement of commodities into the channels of trade and must be readily accessible to the co-operative or its sales agent. Devising methods whereby they can serve as credit instruments, and yet be available to facilitate necessary grading and processing and to permit the shipment of products, is a problem for all agencies financing agricultural products. Commercial banks have not completely solved it any more than have the Intermediate Credit Banks. The latter, however, must function in line with legal technicalities which do not allow them the flexibility of commercial banks. Commodities which must be graded or processed after the original warehouse receipt is issued cause special difficulties. Trust receipts which permit the release of necessary documents have been developed to meet these situations. Details of the arrangements vary, but the use of these receipts in releasing wool for grading purposes will show how the Intermediate Credit Banks avoid undue interference with the marketing and processing of commodities on which they have made advances.

Some wool is sold in the original bags, but many bags must be opened for sorting, grading, or scouring purposes. If the original warehouse receipts are already pledged as collateral they must be surrendered before the bags are released, since warehousemen must maintain intact the property described in outstanding receipts. As a matter of trade practice, warehouses operating under state licenses permit receipts to remain outstanding even though bags are opened and the wool graded. Federally licensed warehousemen, however, by a ruling in 1928, were instructed to demand the surrender of the receipts describing particular bags whenever those bags were opened for grading purposes.

The Intermediate Credit Banks refused to loan on state warehouse receipts based upon wool in the process of grading which could not be identified. Since grading operations often involved 25 or 30 per cent of the wool represented by outstanding warehouse receipts, this attitude was not unreasonable; but arrangements for grading had to be made. Consequently the Intermediate Credit Banks provided that trust receipts could be issued by the independent selling agency and substituted for the warehouse receipts which the custodian bank surrendered. These trust receipts are limited to a maximum of 25 per cent of the wool pledged to secure loans. As a further protection to the Intermediate Credit Bank the warehouseman, the selling agency, and the co-operative furnish a blanket surety bond which equals the total amount of the advances made upon the security of warehouse receipts for which trust receipts are substituted. In this way the interests of the bank are protected and at the same time storage receipts are released and the regular grading accomplished.²⁹

No standard arrangement can be recommended by which the flexibility necessary to facilitate marketing can be introduced into the handling of documents. Each commodity offers its own particular problems of storage, grading, and shipments. Each association has its own methods of handling deliveries and making payments to members, its own sales policies, and its own capital limitations; and warehouse accommodations at delivery points vary widely. However, the Intermediate Credit Banks are rapidly devising means by which co-opera-

²⁹ Before this arrangement had been worked out the Intermediate Credit Banks were informed that certain co-operatives were planning to obtain credit elsewhere. This was the immediate result of the ruling prohibiting the grading of wool in federally licensed warehouses against which warehouse receipts were outstanding.

tives with legal title to eligible commodities, evidenced by the appropriate documents, can obtain loans promptly and on terms that do not interfere with their marketing functions.

A summary statement of all objections to the Intermediate Credit Banks as sources of commodity loans, made by the Treasurer of a co-operative association, covers the case admirably. In his opinion the chief reason Intermediate Credit Banks fail to render the maximum service to co-operatives is because they are required to operate in line with all the technicalities of a law which was passed before the financing of co-operatives was developed in this country and before anyone was in a position to know what their needs would be. As we have pointed out, considerable progress has been made in discovering these requirements and in adapting the machinery to meet them.

Much of the present criticism is beside the point and arises from misconceptions as to the credit status which co-operatives have rightly earned. Quite often the loan service of the Intermediate Credit Banks to co-operatives is compared with the service, rates, and terms which commercial banks offer to their commercial customers dealing in similar commodities. Such comparisons are not valid. Commercial banks may advance a cotton brokerage house a larger percentage on cotton than a co-operative receives because the amount and form of its working capital warrant the narrower margin. A well-established co-operative, with substantial working capital and a large deposit account, might receive similar credit terms. Very few co-operatives approximate this situation. They are in most cases organized without capital stock; they have a minimum amount

of liquid working capital; and their cash balances are small. Moreover, co-operatives are innovations in our marketing system and have not yet demonstrated their stability and efficiency as marketing agencies. Commercial traders obtain larger advances if commodities are hedged; so also do co-operatives. However, the principle of co-operative marketing assumes that prices are not fixed at delivery or at a particular date, but that members will receive the full sales price minus operating costs. In brief, the very nature and purpose of co-operative marketing invalidate comparisons with rates and terms allowed commercial dealers.

Similarly, erroneous comparisons are made between services of the Intermediate Credit Banks and commercial banks. Additional costs are not balanced against the unusual risks which often bar a co-operative from financing through metropolitan banks under any terms. Lower interest rates are accepted as a result of an improved mechanism but without adequate recognition of the fact that they depend upon the rejection of all loans that involve any appreciable risks. So long as certain precautionary measures contribute to maintaining the confidence of investors in Intermediate Credit Bank debentures, they cannot be eliminated without increasing the cost of funds and thus losing one of the advantages that co-operatives value.

CHAPTER XI

OTHER LOAN SERVICES FOR CO-OPERATIVES

When measured in terms of dollar volume, loans for marketing purposes and the discounting of crop production and livestock loans for members represent the major services rendered to co-operative associations by the Intermediate Credit Banks. But if we are to get a complete picture of the service rendered, we must note two other credit services designed to strengthen the co-operative movement. They are (1) the discounting of pre-shearing advances made to wool growers and of loans secured by the borrower's equity in stored cotton, tobacco, and grain; and (2) loans to co-operative purchasing associations. The Agricultural Credits Act did not provide direct means for the latter to obtain working capital from the Intermediate Credit Banks, but at least two co-operative buying associations have devised indirect methods of doing so.

I. COMMODITY LOANS TO MEMBERS OF CO-OPERATIVES

Although the commodities pledged for equity loans and pre-shearing advances are eligible collateral for direct loans, the Intermediate Credit Banks cannot loan directly to individuals.¹ If farmers wish to borrow on these commodities they must obtain credit through a qualified agricultural credit corporation or a commercial bank which will indorse the paper. No accurate estimate of the volume of equity loans and pre-shearing

¹ Equity loans refer to advances made to individual borrowers on the security of warehouse receipts or participating certificates evidencing their equities in crops delivered to co-operative marketing associations.

advances discounted by the Intermediate Credit Banks can be made, since reports to the Farm Loan Board do not separate them from other discounts. But co-operative associations were prompt to exploit this opportunity to gain the loyalty of members by making credit available on the security of their commodities.

Equity loans have been limited for the most part to loans on the staple commodities of tobacco, cotton, and wheat.² At present the Intermediate Credit Banks hold very little of such paper, although a substantial volume was discounted prior to 1926. While equity loans, like pre-shearing advances, are made at the instance of co-operative associations for the benefit of their members, a few agricultural credit corporations have attempted to accommodate non-members and members alike. Since the problems and risks in equity loans are quite similar regardless of the commodity involved, our discussion will be confined largely to loans on warehoused tobacco and cotton.

The purpose of equity loans is to increase deliveries to co-operative marketing associations. They are designed to supplement the initial payment at time of delivery in order that members may meet their current obligations and be free to deliver their entire crop to the co-operative association. The fact that these loans are really additional payments made previous to a final settlement for delivered commodities is significant from the point of view of the credit risks involved. As we learned in the preceding chapter, initial payments to

² Members of the Georgia Peanut Growers' Association borrowed on their peanut equities in 1924 and in 1925, but these loans were discontinued when the co-operative association dissolved after some irregularities in issuing warehouse receipts had involved it and its creditors in losses.

members are limited to the percentage co-operatives can borrow on the commodities they hold. For the chief staple crops loans range from 50 to 70 per cent, and only occasionally amount to 75 per cent of the current values of the crop. Since these advances are quite conservative, there is a constant temptation for producers to sell at least a part of the crop outside the association in order to realize upon it immediately. Sometimes the first advance is not sufficient to furnish funds for harvest expenses and, if prices are low, it may be less than the obligations already incurred in producing the crop. Co-operatives found that, unless they could increase their advances or supplement them by additional loans, they were in danger of losing deliveries to commercial buyers.

Equity loans are also used to minimize the dissatisfaction caused by the long delays before final settlement for crops. The tobacco associations in particular followed a sales policy that resulted in indefinite delays, which members resented bitterly. The Burley Tobacco Growers' Association made an initial advance which proved to be 53.7 per cent of the final value of 1923 deliveries, and not until June 1925 did it make a second payment. Final settlement occurred in December 1927, more than four years after the crop was delivered. On the two succeeding crops second payments were delayed two years and final settlement was made in the fall of 1927.³ Since the first advances proved to be only 50 per cent of the complete returns, a delay of several years before the final settlement worked a real hardship upon small farmers with little or no working capital and aroused considerable dissatisfaction.

³ Data concerning the Burley Tobacco Growers' Association are from an unpublished manuscript by E. C. Johnson, which the author kindly permitted to be used in this connection.

Inasmuch as equity loans are supposed to encourage deliveries, co-operative marketing associations have assumed the major responsibility for providing operating capital for credit corporations handling this type of paper. A co-operative may use accumulated reserves to purchase stock in a credit corporation, or may make unsecured loans to a credit corporation to supplement its paid-in capital. If non-members as well as members are accommodated, or if the corporation is interested primarily in making crop production loans, borrowers or private business men may also contribute some capital.*

Because of certain elements of safety some credit managers rate equity loans as high-class paper. The underlying security is a staple, readily marketable commodity, while the close tie-up between credit corporations and the marketing associations simplifies collections. If there is a ready market for the commodities and they are fully insured and satisfactorily warehoused, the loans are quite safe so long as adequate margins are maintained.

* A very anomalous situation arose out of the attempt of the Tobacco Growers' Co-operative Association of Virginia, North Carolina, and South Carolina to contribute to the operating capital of the Agricultural Credit Corporation of Virginia (Danville), which planned to rediscount equity notes of members and non-members alike. More than 500 private business men and farmers contributed approximately \$156,000, but additional funds were needed. The tobacco association placed \$80,000 at the disposal of the credit corporation but no shares were issued for this amount. The exact legal status of this fund was somewhat in doubt. On the books of the co-operative it appeared as "cash on deposit," for the co-operative was not authorized to make loans. But the credit corporation was not permitted to receive deposits, so it carried the item on its books under "accounts payable." Regardless of legal niceties the co-operative association was sufficiently interested in the venture to contribute heavily to its working capital although equity loans were not restricted to members. However, when the credit corporation liquidated and was forcing collection of notes, the makers were not allowed to offer as a defense that their claims against the Tri-State Tobacco Growers' Association for tobacco should be offset against the credit corporation's claim for unpaid balances on their notes. At no time did the co-operative association admit any other relationship to the agricultural credit corporation than that of creditor.

Proceeds from sales are received by the co-operative, which has legal notice that the member's equity in his crop is pledged to secure his note. Before final settlement is made his loan is liquidated.

Nevertheless equity loans have been the source of heavy losses to a number of credit corporations, and at least one Intermediate Credit Bank regards them with so little favor that it refuses to discount them.⁵ There are several grounds for this distrust of equity loans. In the first place, their margin of safety is likely to be small. Second, certain moral hazards are added because of the attitude of borrowers toward these obligations. And finally, the operating expenses are too high in proportion to interest income or the indirect benefits accruing to the credit corporation. The objections are particularly well founded if the credit corporation is operated independently of a co-operative marketing association.

The margin of safety on equity loans is bound to be dangerously small, for the first advance to members represents as much as the Intermediate Credit Bank is willing to lend upon delivered commodities. Although the indorsement of a credit corporation is additional security, it offers little protection if all the paper rediscounted by the corporation is inadequately secured. When 50 per cent of the value of tobacco is advanced upon delivery, equity loans frequently add another 25 per cent, bringing the total advance to the maximum allowed by law.⁶ If the commodity is valued conserva-

⁵ See W. H. Rowe, *The Texas Cotton Growers Finance Corporation* (preliminary mimeographed report), Bureau of Agricultural Economics of the U. S. Department of Agriculture, March 1931.

⁶ In addition to the initial advance the Burley Tobacco Growers' Credit Corporation advanced 25 per cent on tobacco equities in 1923 and 50 per cent in 1924 and 1925. In 1926 the amount of the advance was left to the discretion of the president and secretary, but almost no loans were made.

tively, this margin may prove adequate. But declining prices may wipe out the entire margin of safety or, if sales are long delayed, insurance, storage costs, and handling charges may leave less than nothing for distribution. Presumably over-payments can be adjusted the following crop year, but experience has shown that future deliveries are highly uncertain if refunds are expected. Furthermore, commodities like tobacco or peanuts do not have continuous markets which permit the corporation to sell out promptly if margins are threatened. Finally, unless the credit corporation and co-operative association work in close harmony or are controlled by the same officers, administrative difficulties make prompt action to protect margins impossible.⁷

Margins on equity loans secured by warehoused cotton or wheat are more easily protected, particularly if the loans are made by a corporation subsidiary to the co-operative association. Daily price quotations give an accurate market valuation of the security and the co-operative can move to protect the corporation's interest at any moment. But, on the other hand, margins of safety on cotton and wheat loans are narrower than on other commodities. Direct loans to co-operatives secured by the pledge of these products average 65 to 70 per cent of a fair market value. An additional advance of 2 cents a pound on cotton selling at 15 cents brings the total loan above 75 per cent of the fair market value, which is the maximum advance for direct loans. A slight drop in price may then wipe out the remaining equity. Therefore a credit manager is obliged to watch the status of individual accounts with great care to avoid losses from

⁷ An interlocking directorate for the agricultural credit corporation and the marketing association is not wholly desirable, for the interests of the latter in increased deliveries may be at variance with conservative credit policies.

vanishing margins. And if he calls for additional margins or sells out on a declining market, members are displeased and resentful. Thus, although equity loans are supposed to enhance membership loyalty, they may become a source of irritation.

The attitude of borrowers toward their obligations also adds certain moral hazards. Quite often members who pledge their participation certificates as security for loans do not recognize that they are signing an unconditional promise to pay a certain sum of money. Too frequently they dismiss the obligation from their minds on the assumption that they have received a second payment on their crop. To be sure they pay 6 or 7 per cent for this accommodation, but nevertheless they consider that they have anticipated the final settlement rather than incurred a definite obligation to pay a note at maturity.

It is of no practical importance that a borrower regards his loan as a payment for value received rather than as a liability so long as an affiliated co-operative holds unsold commodities exceeding in value the amount of the loan, but this point of view becomes serious if the credit corporation has no connection with the marketing association either legally or through its management, or if the association ceases to function. When the Tri-State Tobacco Growers' Co-operative Association was placed in the hands of receivers the collection of tobacco equity loans made by the Agricultural Credit Corporation of Virginia presented a serious problem. This corporation, which at one time had half a million dollars outstanding on tobacco participation certificates, was liquidated along with the co-operative association.⁸ Collections were ex-

⁸ The decision to discontinue loans had been made in the spring prior to the bankruptcy proceedings. In the liquidation process the affairs of

ceedingly difficult. Many loans had been made to small tenant farmers and share croppers. The latter changed their post-office addresses every season or two and their few business or social connections did not always warrant leaving forwarding addresses. Often they were not located for several years and then quite by chance.⁹ In many cases they did not understand that they had signed promissory notes and were being held for the principal and accrued interest. They considered their transactions with the co-operative and the credit corporation closed when they surrendered their participation certificates as security for the loan.

Unfortunately, from a credit point of view, a majority of the applicants for equity loans are small farmers, frequently tenants, whose financial statements do not justify a loan if one takes into consideration the fact that they are assuming an obligation to pay regardless of the ultimate value of their equities. Some credit corporations making equity loans actually stressed the point that loans were made not on the financial strength of the borrower but on his participation certificates. That is, loans were made to share croppers as readily and on the same terms as to landlords.¹⁰ Consequently if assigned equities were

the credit corporation and the co-operative association were meticulously separated. All suits for collection were in the name of the credit corporation and the creditor banks. A defense that the value of the farmer's unsold tobacco held by the co-operative association should be offset against his note to the credit corporation was never accepted in court because no legal connection between the two organizations was established.

⁹ These statements are based upon records of the Agricultural Credit Corporation of Virginia and on personal interviews with former officers of the corporation and the auditor in charge of its liquidation.

¹⁰ Although the Intermediate Credit Bank of Louisville required the Burley Tobacco Growers' Credit Corporation to secure financial statements for all loans of \$200 or above, in actual practice the sole security for the loan and the only source of payment was the borrower's equity in his crop.

insufficient to liquidate a note it often proved uncollectable, for the borrower had little or no assets upon which the corporation could levy and other creditors frequently held prior liens on future crops.¹¹

Even from the point of view of co-operative associations equity loans are at best a qualified success. The returns in interest income scarcely justify the use of reserve funds belonging to all members to guarantee individual loans in order that a few members may receive a more generous first payment. The Burley Tobacco Growers' Credit Corporation showed a modest return on the capital invested by the co-operative, but many of the costs of operation were shared by the marketing association. Although the credit corporation accommodated 7,608 growers, mostly in the 1925 season, this number represented only 7 per cent of the total membership. Since a majority of the borrowers are small growers, the net increase in deliveries directly attributable to equity loans must be slight.¹² If loans are limited to amounts that can be liquidated, even though prices decline sharply as the season advances, the credit corporation can avoid losses; but, if ultra-conservative policies must be followed, the loan service ceases to be of material assistance to those members most in need of relatively large initial advances.

The readiness with which the cotton finance corporations relinquished this portion of their credit program as soon as the Federal Farm Board began to make supple-

¹¹ The capital of the agricultural credit corporation rediscounting equity loans is invested in marketable securities and pledged with the Intermediate Credit Banks as additional collateral but, if many loans prove bad, the banks are not adequately protected against loss.

¹² The average loan made by the Burley Tobacco Growers' Credit Corporation was only \$103, while 20 per cent of all loans average less than \$50. Data are from the unpublished manuscript of E. C. Johnson.

mentary loans reflects their lack of enthusiasm for equity advances. If 75 or 80 per cent can be advanced safely upon delivered commodities, and if initial payments of this amount are necessary to hold deliveries, co-operatives will do better to accumulate working capital to supplement their direct loans from the Intermediate Credit Banks. If initial advances are so small that they do not cover the amount of the production loans which mature at harvest time, some arrangement other than additional loans to members should be devised.¹³ Credit corporations may be financing growers who are more dependent upon borrowed funds than successful producers can afford to be. In the interests of profitable agriculture, and in fairness to the more efficient producers, co-operatives should hesitate to grant special favors to weak members. Moreover, from a credit point of view, they cannot afford to assume the risks of such financing.

Indefinite delays before final settlement for deliveries may be avoided by changes in selling policy. The concept of orderly marketing is rapidly changing from an emphasis upon regular sales throughout the year to a policy of adjusting volume of sales and prices to prevailing market conditions. A sales policy that will dispose of one crop before the opening of another season, or at least that will prevent progressive accumulation of inventories, is gaining favor. If modifications in sales policy do not expedite settlements sufficiently to avoid complaints and hold deliveries, co-operatives would do better to accumulate enough working capital to finance

¹³ Stanley Reed, "Financial Structure of Co-operatives," *American Co-operation*, 1931, Vol. I, p. 82. In commenting on the credit corporation as a subsidiary he makes the point that "care should be taken to see that growers liquidate the production loans with the advances upon delivery of the commodity."

their marketing program, at least in part, so that they can compete with commercial buyers without undertaking hazardous credit operations which at best serve only their more necessitous—or possibly more articulate—members.

The operating experience of cotton associations thus far leads to the conclusion that equity loans will not figure largely in their credit programs. If tobacco co-operatives become an important factor in the marketing of tobacco, they may find it advisable to organize credit corporations as adjuncts to their marketing association. But they must recognize that these credit corporations are strictly service departments and not self-supporting organizations. However, any conclusions in regard to equity loans are subject to amendment in the light of future action by the Federal Farm Board. If a portion of its funds is ear-marked permanently to supply supplementary loans, equity loans quite likely will be discontinued entirely.

Somewhat different conclusions are warranted in respect to pre-shearing advances. Such loans are made on the security of wool growers' notes secured by a chattel mortgage or bill of sale in favor of the co-operative which markets their wool.¹⁴ Since these loans are in reality a partial payment of the first advance which the co-operative makes to members there is little chance for overpayment; and since in pre-shearing loans the credit corporation is not dealing with itinerant farmers having little or no investment in their business, as is often the case with cotton and tobacco loans, there is less danger of loss. Advances range from 50 cents to \$1.00 per fleece,

¹⁴ The bill of sale is satisfactory security for loans only if the state law recognizes it as such and provides for recording it.

depending upon the market price for wool, which means that individual loans average much larger than equity loans and consequently cost less to place. Moreover, a few hundred loans represent a substantial volume of business for the association.

Since commercial buyers stand ready to make pre-shearing advances co-operative marketing associations must do likewise if they expect to persuade wool growers to sell co-operatively. The Pacific Wool Growers' Credit Corporation, a subsidiary of the Pacific Wool Growers' Co-operative Association, makes sheep loans primarily but plans to take over and develop the pre-shearing advances which were formerly financed by the marketing association. When the National Wool Marketing Corporation was set up in February 1930 a loan of 1 million dollars was negotiated with the Federal Farm Board to capitalize a credit corporation. In 1931 this corporation made pre-shearing advances of from 50 to 75 cents per head, amounting to a total of 4.6 million dollars.¹⁵ Since the Federal Farm Board is apparently convinced that an expansion of such loan services will strengthen the wool co-operatives, it is safe to assume that pre-shearing advances will continue to expand.

II. FINANCING CO-OPERATIVE PURCHASING ASSOCIATIONS

The commodities which co-operative purchasing associations handle are not acceptable collateral for direct loans from the Intermediate Credit Banks. The Agricultural Credits Act stipulates that such loans must be secured by warehouse receipts or shipping documents conveying title to staple, non-perishable, readily marketable agricultural commodities. The inventories of purchasing

¹⁵ "Federal Financial Aid in Wool Marketing," *U. S. Daily*, Aug. 24, 1932. Statement prepared by the Federal Farm Board.

co-operatives consist of agricultural equipment and supplies used in production instead of staple commodities moving into distributive channels. Therefore buying associations can gain access to the Intermediate Credit Banks only by discounting their own notes secured by notes of members through an auxiliary credit corporation.¹⁶

Thus far the Farm Loan Board has shown considerable reluctance in approving the use of Intermediate Credit funds in financing co-operative purchasing associations. Production loans are made to individual producers through agricultural credit corporations to enable them to patronize their co-operative supply company, but it is quite another matter to furnish purchasing associations with working capital to enable them to carry their inventories. The official attitude is that credit advanced for working capital is used for commercial rather than agricultural purposes. One officer expressed this attitude succinctly by pointing out that the Intermediate Credit Banks do not finance cut-rate drug stores or chain grocery stores although they both sell necessary supplies to farmers at advantageous prices. Retailing of dairy feeds, fertilizer, barrels, or spray materials is a mercantile and not an agricultural enterprise, regardless of the

¹⁶ "Rules and Regulations of the Federal Farm Loan Board," *Federal Farm Loan Board Circular No. 15*, August 1923, provides that:

"Organizations, whether co-operative or otherwise, engaged in buying feed, fertilizer, or other agricultural commodities, and distributing such commodities among their farmer members, cannot borrow directly from the Intermediate Credit Banks, even though such commodities shall be warehoused and warehouse receipts offered thereon as security. Farmers wishing credit for the purchase of agricultural products, machinery, livestock, or other equipment to aid in agriculture, can reach the Intermediate Credit Banks only through commercial banks, properly capitalized agricultural credit corporations, or livestock loan companies, all of which may take such paper and rediscount with the Federal Intermediate Credit Banks."

fact that it may be organized on a co-operative rather than a profit-seeking basis.

Co-operative purchasing associations are not all equally dependent upon outside sources for credit. Supply companies carrying a limited number of items and buying on terms which allow them to collect from patrons before payment is due have very small working capital requirements, especially if their customers can negotiate production loans and pay cash for purchases. Purchasing departments organized by cotton associations to retail fertilizer are quite independent of outside financing so long as members pay cash. And, as we have already seen, members can pay cash if they can borrow from a credit corporation rediscounting with the Intermediate Credit Banks.

Other buying associations cannot accomplish this rapid turnover and so require funds to carry seasonal purchases until needed. Growers of alfalfa seed, for instance, are anxious to realize upon their crop in the fall, but farmers of Michigan and the Corn Belt are not prepared to make outlays for seed until spring. Co-operative purchasing associations, if they expect to replace commercial distributors, must be prepared to perform the functions of commercial middlemen. Because of their highly seasonal credit needs and the often slow turnover of their inventories, however, local commercial banks are unwilling to finance them. Consequently the associations are urging that Intermediate Credit Bank funds be put at their disposal more freely, but thus far they have met with little success.¹⁷

¹⁷ 71 Cong. 1 sess., *Agricultural Relief*, Hearings before House Committee on Agriculture, Mar. 29, 1929, Serial A, Pt. 3, pp. 237-58. (Testimony of I. H. Hull, general manager of the purchasing department of the Indiana Farm Bureau.) See also C. L. Brody, "Purchasing

The savings in cost of production attributed to co-operative purchasing of supplies make adequate financing of these ventures of major importance to producers. Not only are unit production costs reduced through lower prices, but opportunities for improvement in the quality and yield of crops are offered by the development of expert purchasing services for the benefit of members. The recent increase of membership in co-operative purchasing associations and the volume of business they handle give ample evidence of the interest in this aspect of co-operative effort in reorganizing agriculture, and indicate the extent of the field of financing that might be developed.¹⁸

Although the Intermediate Credit Banks have not encouraged purchasing associations to apply for loans, a limited amount of credit has been extended to a few associations. The Eastern States Exchange, Springfield, Massachusetts, and the Co-operative Grange League Federation, Ithaca, New York, have organized subsidiary credit corporations to discount with the Springfield Bank; but in June 1929 their total borrowings fell short of half a million dollars, which is a negligible sum when one considers that together they buy feed and supplies for 50,000 or more farmers in the Northeastern dairy states.¹⁹ Outside of the Springfield District co-operative purchasing associations have not borrowed from the Intermediate Credit Banks and, unless the Farm Loan Board modifies its position, other buying associations are not likely to be able to qualify for discount privileges.

Activities of the Michigan State Farm Bureau," *American Co-operation*, 1929, p. 447.

¹⁸ See "Co-operative Marketing and Purchasing 1920-1930," *U. S. Department of Agriculture Circular No. 121*, August 1930.

¹⁹ 71 Cong. 1 sess., *Agricultural Relief*, Hearings before House Committee on Agriculture, Apr. 3, 1929, Serial A, Pt. 7, p. 615. (Testimony of John D. Zink, general manager of the Eastern States Farmers' Exchange.)

In theory there seems no reason why the method devised by the Eastern States Exchange, through which it borrows on the security of members' notes, might not be adopted by other buying associations. Farmers placing advance orders for dairy feed or grain give their notes for the amount of their purchases. The Eastern States Exchange then gives its own note, collateraled by the farmers' notes, to its subsidiary credit corporation, which has qualified for discount privileges. This note, after being indorsed by the credit corporation, is discounted with the Springfield Bank. In this roundabout manner the purchasing association obtains working capital for nine months or a year to finance the purchase of supplies.²⁰ Each farmer pays cash for his purchases at the time of delivery. After he has received and paid for his entire order and the credit corporation has reduced its indebtedness with the Springfield Bank, his note is cancelled and returned to him. At no time does he put up cash; he merely loans his credit until the co-operative realizes upon its sales.

The amendment of June 26, 1930, authorizing the Intermediate Credit Banks to make loans or advances to agricultural credit corporations on their own bills payable secured by agricultural or livestock paper that is eligible for discount, apparently removes any question as to the propriety of this procedure for obtaining funds, but it does not resolve the question as to whether the proceeds are used in the first instance for an agricultural purpose. Co-operatives which find that advance orders of substantial size are not feasible may experience difficulty in persuading members to lend their credit, particularly if they are required to submit financial state-

²⁰ Commercial banks finance bills of lading while grain is in transit from Western mills to the farmer's station.

ments and demonstrate their ability to take up their notes if the purchasing association cannot meet its obligation at maturity. Furthermore, farm equipment, fertilizer, oil, twine, and feed cannot be brought under the category of staple, non-perishable, readily marketable commodities, and the immediate purpose of loans to associations dealing in such products is to furnish working capital for merchandising operations. The Farm Loan Board apparently has refrained from pressing this second point in respect to the business of the two purchasing associations whose credit subsidiaries have already been granted discount privileges, but the Intermediate Credit Banks avoid enlarging this branch of their service.

Under these circumstances it is probable that the Intermediate Credit Banks will be of little assistance in promoting co-operative purchasing in the absence of organized pressure from farm organizations interested in a comprehensive program of co-operative buying to amend the law so as to make advances to buying associations eligible for discount. Since the Farm Board is encouraging developments in all phases of co-operative effort, the Agricultural Credits Act may be modified so that the Intermediate Credit Banks will be given a special responsibility for financing purchasing associations, provided they can offer collateral security that safeguards their loans. Broadening the eligibility requirements to include non-perishable supplies to be used in agricultural production need not endanger the credit of the system. But if the purchasing associations are non-stock organizations, notes should be indorsed by a capital stock agricultural credit corporation in order to protect the discounting bank.

Unless changes are made along these lines the Inter-

mediate Credit Banks cannot become an important source of working capital for co-operative merchandising ventures and will thus fall short of their potential service to co-operatives. But the fact that government owned banks would be directly engaged in financing competitors of private mercantile establishments is likely to prevent any change in the law which would give purchasing associations access to Intermediate Credit Bank funds.

Clearly co-operative marketing associations are very well served by the Intermediate Credit Banks. They can obtain loans directly if they can offer warehouse receipts, shipping documents, or mortgages on livestock as collateral for their loans. In addition, members who have adequate collateral can be accommodated through agricultural credit corporations or livestock loan companies for production purposes or to anticipate returns from the sale of their wool. In sharp contrast to the accommodations which the Intermediate Credit Banks furnish to co-operative marketing associations and their members, co-operative purchasing associations have benefited only slightly from their services.

CHAPTER XII

FINANCING THE FEDERAL INTERMEDIATE CREDIT BANKS

Thus far in our discussion of the Intermediate Credit system we have been interested primarily in the way in which the resources of the Intermediate Credit Banks are placed at the disposal of individual farmers and their business organizations. We have tacitly assumed that there was at all times an adequate flow of funds into the coffers of the Intermediate Credit Banks. In this chapter attention will be given to the legislative provisions which were made for financing the system and to the way they have been working in actual practice.

In Chapter IV we noted that the capital necessary for the establishment of the Intermediate Credit Banks was furnished by the United States Treasury and that as a means of securing additional funds each bank was given the right to sell collateral trust debenture notes secured by either agricultural or livestock paper. It was obvious from the start that if the banks were to make loans in any considerable volume they would have to procure funds (1) through the sale of securities, (2) through rediscounting their paper with the Federal Reserve Banks, or (3) through the sale of acceptances and notes in the open market. We shall now see whether the Intermediate Credit Banks are well enough integrated with our banking structure and the open money market to assure agriculture a dependable supply of credit.

I. THE SALE OF DEBENTURES TO PRIVATE INVESTORS

Of the various methods that could be used for financing the Intermediate Credit Banks, the sale of collateral

trust debenture notes is the most adaptable. The debenture is a credit instrument peculiarly suited for providing agricultural paper with a wide market. Intermediate Credit Bank debentures are secured by the general assets of the twelve banks and by the pledge of specific collateral deposited with the Farm Loan Registrar of each district. It is only through the use of a credit instrument of this nature that notes of individual farmers can be put into such form that they are salable over a wide area. It is not reasonable to expect a distant investor to trust an individual's note, as he has no way of assuring himself of its reliability. But when thousands of notes are gathered together, trusteeed and indorsed by a bank, and made the security of collateral trust debentures, which are the joint obligations of a group of responsible banks, an adequate degree of safety is assured.

Thus far the Intermediate Credit Banks have relied chiefly upon the sale of debentures. In fact they have not called upon the Treasury to furnish them the full amount of 60 million dollars provided by the Agricultural Credits Act. Two banks, the Columbia and the Berkeley, because of substantial losses, have called the entire 5 million dollars allotted to them, while the Spokane and Houston Banks have each called 3 million. The others have requested only 2 million dollars each. The system as a whole has 28 million dollars of uncalled capital to fall back upon. At the outset the banks refrained from requesting all their capital because they wished to hold as much as possible in reserve for emergency use if at any time the condition of the money market made it difficult to sell debentures in sufficient volume to meet demands for loans. The desire to make a place for their debentures in the open money market was an-

other reason for following this policy.¹ Consequently from the very beginning they offered small amounts of these securities for sale in order to acquaint the public with their character and to pave the way for selling a large volume at a later date.

The Intermediate Credit Banks take the initiative in issuing debentures. Whenever one of them anticipates the need for additional funds, it makes application to the Farm Loan Board for permission to issue a block of these securities. The Agricultural Credits Act, although it grants each Intermediate Credit Bank the power to issue debentures to the amount of ten times its paid-up capital and surplus, stipulates that no bank shall issue the securities in any amount without first securing the approval of the Farm Loan Board. The Act also provides that the Board "shall prescribe the rules and regulations governing the receipt, acceptability, substitutions and release of collateral instruments securing these debentures." Even the rate of interest which the issuing bank decides the debenture shall bear is made subject to the approval of the Farm Loan Board.² Thus the provisions of the Agricultural Credits Act insure that the issuance of any securities by the Intermediate Credit Banks will be carefully supervised by the Farm Loan Board. In the final analysis, therefore, the expansion of the business of the Intermediate Credit Banks is under the control of the Board.

The debentures issued by the Intermediate Credit Banks are well secured. While they are in no sense government obligations,³ the provisions of the original Act

¹ *Annual Report of the Federal Farm Loan Board*, 1923, p. 5.

² Of course the condition of the money market determines the rate of yield to the investor.

³ The Agricultural Credits Act expressly states that the U. S. government assumes no direct or indirect liability for them.

governing the way in which they may be issued amply provide for their security. The fact that the debentures issued by the separate banks are the joint liability of all of the twelve banks is an added factor of safety. Moreover, an amendment of May 19, 1932 provides that the Intermediate Credit Banks shall, in accordance with instructions and under regulations of the Farm Loan Board, arrange to make funds available for the payment of debentures and the interest on them whenever they mature. That is, their joint liability becomes effective at the time any obligation falls due instead of after an individual bank has defaulted and its assets have been levied upon to meet its obligations.

There is no danger that an Intermediate Credit Bank will issue unsecured debentures, for the Act specifically provides that all debentures must be secured dollar for dollar by a deposit of cash or of collateral of the type approved by the Farm Loan Board. This collateral consists of notes, drafts, or other such obligations discounted or purchased by the Intermediate Credit Banks in accordance with the provisions of the Agricultural Credits Act governing discounts, and these provisions are also under the supervision and control of the Board.

The Intermediate Credit Banks can put up three types of collateral as security for debentures. The first class consists of notes or drafts made for agricultural purposes and indorsed by an incorporated bank or agricultural credit corporation and (since June 26, 1930) the bills payable of such financing institutions collateralized by individual producers' notes which are eligible for discount. No paper can have a maturity of more than three years, and in actual practice nine months or a year is the usual loan period. Inasmuch as these obligations are a direct liability of the discounting institution or are indorsed by

it, they have as security not only all the assets of the original makers but also the total assets of the discounting corporation. The value of the indorsement of agricultural credit corporations can easily be over-rated, but the policy of requiring them to carry bond reserves to protect their indorsement does assure a substantial margin of safety over and above the individual items pledged.

Although country banks seldom pledge bonds to secure their indorsement, their liability on paper rediscounted is so narrowly restricted and their use of the system so slight that the danger of loss from this source is negligible. No paper can be purchased from or discounted for any bank if its liabilities, exclusive of deposits, already exceed twice the capital and surplus of the bank. Over-extended banks with heavy indebtedness to other institutions are automatically barred from securing much additional assistance from the Intermediate Credit Banks.

Another class of paper which is eligible as collateral for debentures consists of notes or drafts made on livestock and discounted for the most part for incorporated livestock credit corporations. The value of the indorsement of a livestock loan company is subject to the same limitations as the indorsement of agricultural credit corporations handling crop loans and general agricultural paper. The policy of requiring livestock credit corporations to maintain a bond account to strengthen their indorsement has not always been rigorously enforced. At one time there was a real danger that in an effort to attract the business of cattle loan companies operated by large packing interests or companies with ready access to other sources of credit the Intermediate Credit Banks might waive the precaution of substantial reserve accounts. This is less true now than at any previous time, and practically all livestock credit corporations are re-

quired to deposit bonds as additional collateral. The Intermediate Credit Banks, acting under the direction of the Farm Loan Board, are not taking paper of any financing institution until they have first made an examination into the financial status of the applicant. If the organization is not in good condition, its paper is rejected. Periodic re-examinations by Intermediate Credit Bank examiners, usually two a year and sometimes more, keep the banks in close touch with the affairs of all credit corporations.

The third class of paper that may be presented as collateral for an issue of debentures consists of notes or drafts of co-operative marketing associations. In every case these loans are on agricultural products, secured by warehouse receipts, bills of lading, or similar documents. The Act provides that no loan to a co-operative association shall exceed 75 per cent of the market value of the products on which the loan is made. In accordance with the conservative policy that the Farm Loan Board has followed throughout, the banks have limited the loans to more nearly 60 per cent of the estimated market value.

As a general rule it would seem that the collateral securing the debentures will prove sufficient to prevent serious losses. Now and then individual notes will prove worthless; individual credit corporations may suffer losses that will wipe out their entire capital investment; and a collapse of prices such as occurred in the raisin industry in 1927 may involve the Intermediate Credit Banks in losses on direct loans to co-operatives.⁴ But it can hardly be conceived that enough worthless paper will get into the Intermediate Credit Banks to endanger the safety of their debentures. So long as the discounting institution is solvent, the Intermediate Credit Bank will

⁴ The Berkeley Intermediate Credit Bank on Dec. 31, 1932 showed a deficit of \$1,902,914 which is largely the result of losses on raisin loans.

sustain no loss. And now that the system of regular and frequent examinations is followed and the policy of requiring excess collateral is more generally adhered to, there is little danger that an Intermediate Credit Bank will discount paper for an institution that is not solvent.

But if losses do occur, the investor has a substantial element of security in the capital reserves and undivided profits of the system as a whole.⁵ On December 31, 1932 the consolidated balance sheet for the twelve banks showed capital stock, surplus, reserve, and undivided profits in the amount of \$62,166,094, of which \$28,000,000 was uncalled capital. Since there is joint liability for all debentures this statement reflects the true security behind the debentures.

Recently some desirable changes have been made in the provisions for absorbing losses of individual banks. The amendment of May 19, 1932 provides that if the capital of any Intermediate Credit Bank becomes impaired,⁶ it can be replenished by assessments upon the other eleven banks. These assessments are to be apportioned equitably among them as the Farm Loan Board determines. Each bank liable for such an assessment either pays it out of its accumulated surplus or devotes 50 per cent of its net earnings to this purpose. Formerly a bank was forced to show any deficit upon its balance sheet and charge it off against current earnings if possible. Inasmuch as the banks are jointly responsible for all obligations of the system, it is quite legitimate that any bank should be permitted to write off its deficit against the surplus accounts of the other banks. Then the

⁵ Although the Columbia Bank at one time showed a deficit of nearly 1 million dollars, it has gradually reduced this amount until on December 31, 1932 its deficit was only \$623,739. The Berkeley Bank has called all of its capital and shows a deficit of \$1,902,914 as of Dec. 31, 1932.

⁶ 72 Cong., Public No. 138, Sec. 2.

consolidated statement of the twelve banks gives a true picture of the condition of the system without the constant reminder that one or more of them have deficits. It is assumed, of course, that the supervision of the twelve banks is sufficiently centralized to protect the system as a whole against unwarranted extensions of credit by a few banks which are thus relieved of the full consequences of bad banking policies.

More liberal provisions have also been made for the building up of a surplus account which will enable each bank to absorb its own losses. The amendment of May 19, 1932 provides that:

After all necessary expenses of a Federal Intermediate Credit Bank have been paid or provided for, the net earnings shall be paid into a surplus fund until it shall amount to 100 per centum of the subscribed capital stock of such bank, and thereafter 50 per centum of such earnings shall be paid into the surplus. Whenever the surplus thus paid in shall have been impaired it shall be fully restored before payment of the franchise tax herein prescribed. After aforesaid requirements of this section have been fully met and, except as otherwise provided in this Act, 50 per centum of the net earnings shall be paid to the United States as a franchise tax.⁷

During the first ten years of their operations the Intermediate Credit Banks have paid nearly 2.5 million dollars as franchise tax; they have accumulated a surplus of more than 2 million dollars; and, in addition, they had, on December 31, 1932 a surplus and reserves for contingencies of 2.2 millions. It is apparent from these figures that the system can take care of normal losses and gradually accumulate a surplus to weather heavy losses or to enlarge their services. The United States government has relinquished its claim to a franchise tax for an

⁷ The same, Sec. 3.

indefinite period of years, which seems more businesslike than to face the risk that a series of bad years would make it necessary for Congress to be asked to appropriate additional amounts to bolster up the capital structure of the Intermediate Credit Banks. Moreover, substantial surplus accounts, in addition to the uncalled capital, serve to assure investors of the high character of Intermediate Credit Bank debentures.

The market for debentures is almost exclusively with the larger commercial banks of the country, which are located primarily in New York, New Orleans, Philadelphia, Boston, and Chicago. More difficulty is experienced in selling them in the Southeast or on the West Coast because the regional banks in these sections have experienced losses. Despite the fact that debentures are secured by the assets of all twelve banks, local purchasers are influenced by conditions of the bank with which they are most familiar.

Short-term debentures make an ideal investment for surplus funds of commercial banks. Banks of deposit hesitate to tie up their surplus funds for more than a few months at a time, and the maturities of debentures are readily adapted to their requirements. While these securities have not yet been issued in sufficient volume to make them familiar to individual investors, some commercial banks have sold a considerable amount of them to their customers. Because they enjoy the same tax exemption feature and yield a somewhat higher return, they are a more profitable investment than the short-term certificates issued by the Treasury.

Legislation has recently been passed which will broaden the market for Intermediate Credit Bank debentures. It was found that commercial banks preferred

Treasury certificates to debentures in spite of their lower yield because the latter were not eligible as collateral for member bank borrowings at the Reserve Banks. To remove this handicap to their sale Congress amended the Federal Reserve Act to permit member banks to use Intermediate Credit Bank debentures as security for their 15-day borrowings. Now that they are acceptable for this purpose, debentures make a very profitable secondary reserve for commercial banks—and one that can be realized upon immediately.

The demand for debentures has been sufficiently active, except during the tight money period in 1929 and again in 1931 and 1932, to enable the Intermediate Credit Banks to sell them without difficulty at attractive rates.⁸ From the table on page 296 one can see how readily the money market has absorbed these securities.

Although debentures were sold to yield slightly more than 5 per cent in 1929 and at a similar discount the first few months in 1932, in only three years out of ten have they sold to yield more than 4 per cent—and in 1931 the average yield was only 3 per cent. These rates are conclusive proof that Intermediate Credit debentures have taken their place alongside securities of the very best type.

The increase in volume of debentures since 1927 is not entirely an evidence of growth in the requirements of the Intermediate Credit Banks. It represents in part a gradual shortening of maturities in response to investors'

⁸ The Reconstruction Finance Corporation agreed to take any portion of the Feb. 15, Mar. 15, and Apr. 15, 1932 issues of Federal Intermediate Credit Bank debentures, amounting to \$68,025,000, which might be unsold on those dates. Inasmuch as all debentures were sold in the market, it was unnecessary for the Corporation to purchase any part of the issues. 72 Cong., S. doc. 135.

preferences for short-term paper or as a result of an attempt on the part of banks to escape longer commitments when interest rates were temporarily high. In 1930 and 1931, when investors were seeking outlets for surplus funds and yet demanding terms permitting them to reinvest in more profitable enterprises if rates im-

DEBENTURES ISSUED BY THE FEDERAL INTERMEDIATE CREDIT BANKS
1923-32^a

Year	Amount (In thousands of dollars)	Average Rate on Face (Per cent)	Approximate Yield to Investors (Per cent)
1923.....	30,500	4.50	4.57
1924.....	87,150	4.50	3.79
1925.....	80,450	4.50	3.82
1926.....	110,750	4.50	3.93
1927.....	80,750	3.98	3.70
1928.....	110,540	4.30	4.36
1929.....	115,715	4.91	5.06
1930.....	197,925	3.35	3.38
1931.....	198,205	3.27	3.00
1932.....	215,170	3.46	... ^b

^a Data from which this table was prepared were obtained from the Statistical Division of the Federal Farm Loan Bureau.

^b Data are not available to show the yield to investors but it is undoubtedly below the average rate carried by the debentures.

proved, 30- and 60-day debentures were issued whenever necessary to take advantage of low rates, but six-, ten-, and twelve-month paper continued to make up the bulk of the offerings.

II. ACCESS TO THE FEDERAL RESERVE BANKS

When Congress was debating the wisdom of establishing the Intermediate Credit Banks the point was made that they would find it very difficult to secure necessary capital if they had to rely solely upon private investors to purchase their securities. Consequently, in order to in-

sure a market for these debentures, the Federal Reserve Banks were empowered to purchase them. Later the Federal Reserve Act was amended to give the Reserve Banks the right to discount paper for the Federal Intermediate Credit Banks. And finally in 1932 the Intermediate Credit Banks were authorized to create acceptances secured by warehouse receipts or shipping documents covering staple commodities. These acceptances have ready access to the Federal Reserve Banks. It is therefore apparent that the Intermediate Credit Banks are in no sense the last source to which agriculture can go for its intermediate credit. The limiting factor in extending credit to agriculture as well as to other industries is the adequacy of the reserves of the Federal Reserve Banks.

The right that the Reserve Banks have to buy and sell these debentures will probably insure a market for them so long as the Reserve Banks have ample funds to invest in such securities. In the beginning the market for Intermediate Credit Bank debentures was established quite independently of the Reserve Banks. Large commercial banks absorbed the issues without difficulty. The Reserve Banks for the most part have taken odd lots of debentures which the Intermediate Credit Banks had on hand and thereby enabled them to secure small sums of money without going to the trouble and expense of offering an issue in the open money market. But in certain recent years, as shown by the table on page 298, the Reserve Banks have been important purchasers of debentures.⁹

⁹ The Federal Reserve Banks are not compelled to buy Intermediate Credit Bank debentures. Neither the provisions of the Agricultural Credits Act nor the rulings of the Federal Reserve Board require them to do so. But a ruling of the Federal Reserve Board has given them the right to buy such of these securities as do not have a maturity of more than six months at the time of purchase. Whether the Reserve Banks purchase these securities or not will depend entirely upon the administration of these institutions.

At the close of 1928, when call loans were exceedingly attractive, approximately 22 per cent of all outstanding debentures had found their way into the portfolios of the Federal Reserve Banks. Again in 1931, when the security markets were in a state of panic, the Reserve Banks purchased debentures freely. They held 33.2 per cent of

INTERMEDIATE CREDIT BANK DEBENTURES HELD BY FEDERAL RESERVE BANKS, 1923-32
(In thousands of dollars)

December 31	Total Debentures Outstanding ^a	Debentures Held by Federal Reserve Banks ^b	
		Amount	As Percentage of Total
1923.....	30,500	—	—
1924.....	49,710	2,050 ^c	4.1
1925.....	58,699	3,150 ^c	5.4
1926.....	68,580	2,500	3.6
1927.....	51,150	760	1.5
1928.....	44,875	9,825	21.9
1929.....	49,510	2,650	5.3
1930.....	102,475	6,300	6.1
1931.....	78,840	26,185	33.2
1932.....	68,960	—	—

^a Figures are from the *Annual Reports of the Federal Farm Loan Board*.

^b Figures are from the *Annual Reports of the Federal Reserve Board*.

^c Figures were obtained from the Division of Bank Operations of the Federal Reserve Board.

the total amount outstanding on December 31, 1931. The volume of debentures held by the Reserve Banks reached a peak of 32.2 million dollars in January 1932 but declined rapidly in the two succeeding months. For the last nine months of the year the Reserve Banks held no debentures.

This dependence upon the Federal Reserve Banks as

outlets for their debentures was the result of temporary conditions. The abnormal money market which accompanied the stock boom of 1928-29 diverted surplus funds into other channels until the Intermediate Credit Banks found it difficult to dispose of their securities through commercial outlets; and the efforts of all banks in 1931 to strengthen their cash position resulted in larger holdings of debentures by the Reserve Banks. In times of temporary credit disturbances the ability of the Federal Reserve Banks to buy these debentures is of great importance. But if the reserves of these banks are low it is highly improbable that they will wish to invest large sums in these securities. We should not expect the debentures of any institution, either public or private, to be sold at such a time to secure funds to aid in further loan expansion. During normal times, however, there seems little doubt but that the debentures of the Intermediate Credit Banks will have a ready market outside of the Reserve system.

The Intermediate Credit Banks also have access to Reserve Bank funds through the discount privilege. The Agricultural Credits Act gives the Reserve Banks the right to discount agricultural paper for the Intermediate Credit Banks under practically the same conditions that they accommodate their member banks.¹⁰ Nevertheless, it was evidently the intent of the framers of the Act that the Reserve Banks should not accommodate the Intermediate Credit Banks to the detriment of the member

¹⁰ When the amendment of June 26, 1930 gave the Intermediate Credit Banks the power to discount the notes payable of financing institutions secured by individual producers' notes which were eligible for discount, Congress failed to provide that these notes, when indorsed by the Intermediate Credit Bank making the advance, were eligible for discount by the Federal Reserve Banks. This omission, however, was remedied in the amendment of May 19, 1932 (Sec. 5).

banks of the system, for it is specifically provided that each Federal Reserve Bank in discounting paper shall give preference to the present and possible future demands of its own member banks, and that no Reserve Bank shall discount paper for any Federal Intermediate Credit Bank when its reserve ratio is less than 50 per cent of its total liabilities in deposits and Federal Reserve notes in actual circulation.

Furthermore, in order to limit the amount of paper offered for discount, the Federal Reserve Banks are not permitted to discount for any Intermediate Credit Bank at one time more than the total amount of its capital stock and surplus. Neither are the Federal Reserve Banks permitted to discount paper for any of the Intermediate Credit Banks if such paper bears the indorsement of a non-member state bank or trust company which is eligible for membership in the Federal Reserve system.¹¹ Only the paper of non-eligible state banks is able to get admission to the Federal Reserve Banks by way of the Intermediate Credit Banks.

Under no circumstances are the Federal Reserve Banks compelled to discount any paper for the Intermediate Credit Banks. All the Act does is to give them permission to do so. During the first four years the Reserve Banks discounted small amounts of paper for three of the Intermediate Credit Banks, but the total volume in any month previous to 1927 never exceeded 2.5 million dollars. During these years the Intermediate Credit Banks were borrowing, not because of any difficulty in selling their debentures readily and at favorable rates, but in order to secure funds for short periods of time

¹¹ *Digest of Rulings of the Federal Reserve Board 1914-1927, Inclusive*, pp. 133-34.

while they were waiting for the sale of their securities. Their ability to borrow from a Reserve Bank gives an elasticity to their financing that would not be possible if they were wholly dependent upon the sale of debentures.¹² The amount of these borrowings need not be large to make the service of real value.

The conditions under which the Intermediate Credit Banks have borrowed from the Reserve Banks during more recent years are somewhat different. In December 1928 debentures were marketed at rates varying from $4\frac{1}{2}$ to $4\frac{7}{8}$ per cent, while in 1929 and again in 1932 rates advanced to $5\frac{1}{4}$ and $5\frac{1}{2}$ per cent. Several Intermediate Credit Banks rediscounted paper with the Reserve Banks of their respective districts to avoid the higher rates of the investment market. The table on page 302 shows the amount of agricultural paper held under discount for all Intermediate Credit Banks, by months, from January 1928 to December 1932.

The periods of most active borrowing occur at times when the short-term investment market is temporarily tight and debentures can be sold only at unusually high rates. In December 1928 there was \$44,875,000 in debentures outstanding, but the Intermediate Credit Banks drew upon the Federal Reserve Banks for an additional \$12,641,000. This ability to rediscount with the Reserve Banks allows the Intermediate Credit Banks to obtain temporary funds more reasonably at times when short-term investment rates advance sharply.

The Federal Reserve Banks are also empowered to aid in financing the Intermediate Credit Banks through buy-

¹² If they could not rediscount with the Reserve Banks, the Intermediate Credit Banks would be obliged to maintain large bank balances to meet unexpected demands for loans.

ing and selling their debentures in the open market.¹³ Thus far, however, the Reserve Banks have purchased in the open market only a limited volume of these debentures.¹⁴ Commercial banks purchasing debentures are ordinarily not desirous of reselling them, and consequently only a limited volume has been in the open market.

AGRICULTURAL PAPER DISCOUNTED BY THE FEDERAL RESERVE BANKS FOR
THE INTERMEDIATE CREDIT BANKS, 1928-32^a
(In thousands of dollars)

Month	1928	1929	1930	1931	1932
January.....	\$ 723	\$15,241	\$1,010	—	\$10,801
February.....	57	12,222	250	—	10,573
March.....	252	13,337	1,043	121	5,916
April.....	572	9,388	1,401	58	4,643
May.....	107	3,420	1,076	—	408
June.....	412	5,790	656	370	528
July.....	962	5,439	124	—	605
August.....	2,826	1,593	296	—	80
September.....	6,136	4,355	365	77	285
October.....	11,700	3,160	117	9,073	330
November.....	11,872	2,332	1,111	11,320	466
December.....	12,641	1,094	737	11,044	349

^a Figures represent volume held at close of each month. Data for the years 1928-30 are from the *Annual Reports of the Federal Reserve Board* (1928, p. 195; 1929, p. 183; 1930, p. 49). The 1931 and 1932 figures are from the *Federal Reserve Bulletins*.

Now that they are eligible as security for member bank borrowings there will be a wider market for them and they may well become an important type of security dealt in by the Reserve Banks in order to put the system's open market policy into effect, particularly if the Intermediate Credit Banks ever do a large volume of busi-

¹³ Federal Reserve Act, Sec. 13a.

¹⁴ See *Annual Report of the Federal Reserve Board*, 1927, p. 154, for the volume of debentures bought in the open market from 1924-27 inclusive. Data for recent years are not available.

ness. This assumes of course that their securities maintain a high credit standing.

The Federal Reserve Banks are also empowered to purchase and sell in the open market the acceptances of Federal Intermediate Credit Banks.¹⁵ Through an oversight Congress failed to give the Intermediate Credit Banks power to create acceptances, and so this provision of the original Act was ineffective until the amendment of May 19, 1932 specifically authorized the banks "to accept drafts or bills of exchange issued or drawn by any such [co-operative] associations when secured by warehouse receipts and/or shipping documents covering staple agricultural products as herein provided."¹⁶

Now that any doubt as to the right of the Intermediate Credit Bank to create acceptances has been removed, they can obtain funds from the Reserve Banks through the sale of acceptances to them. Although Section 14 of the Federal Reserve Act states that the Reserve Banks are to purchase and sell these acceptances whenever "the Federal Reserve Board shall declare that the public interest requires," it is doubtful whether this means that the Federal Reserve Board has the power to compel the Reserve Banks to buy them. It is unlikely that the issue will arise, however, since these acceptances must be secured by warehouse receipts or shipping documents covering staple commodities, which means that the acceptances of any Intermediate Credit Bank should have a ready sale.

Whether the ease with which the Intermediate Credit

¹⁵ Section 14 of the Reserve Act was amended by the addition of a new paragraph which gave the Reserve Banks the right to purchase and sell in the open market the acceptances of the Federal Intermediate Credit Banks and of the National Agricultural Credit Corporations.

¹⁶ 72 Cong., Public No. 138.

Banks may utilize the Federal Reserve Banks contains an element of danger it is difficult to say. Admittedly the extent to which these several provisions are used rests primarily with the Federal Reserve Board and the Reserve Bank management. Whether it is undesirable for the Intermediate Credit Banks to have easy access to reserve funds depends entirely upon the administration of the institutions. So long as they are conservatively managed no danger will result. An opportunity is afforded, however, which it is possible to abuse.¹⁷

Undoubtedly the Agricultural Credits Act makes liberal provisions for insuring an adequate source of funds for the Intermediate Credit Banks. In the first place, they are given the right to issue tax-free debentures in convenient denominations and with maturities adjusted to appeal to a wide variety of purchasers. Banks with inactive deposits, insurance companies with temporary funds to invest, and private individuals can easily be reached either directly or through the medium of investment houses with wide clienteles. If these sources should prove insufficient to provide a market for the debentures, the way is open whereby the Intermediate Credit Banks can tap the resources of the Federal Reserve Banks either through rediscounting or through the sale of debentures and acceptances.

There is little doubt that so long as there are loanable funds seeking investment, and so long as the debentures are well secured, the Intermediate Credit Banks will have

¹⁷ Very likely member banks will raise objections if the Intermediate Credit Banks are given too free use of reserve funds inasmuch as they do not contribute any capital to the Reserve Banks or maintain deposits with them. But since the Intermediate Credit Banks do not share in the earnings, there is little reason for serious objection provided there is no infringement upon the rights of member banks to receive accommodation.

little difficulty in marketing their securities in competition with other offerings. In spite of the rapid growth in the volume of debentures offered during 1930-32, they have been disposed of at very favorable interest rates. To the extent that the success of the system depends upon the Intermediate Credit Banks securing adequate funds to carry on their operations, barring periods of general credit stringency, the experience to date seems to warrant the conclusion that there will be little difficulty in financing their operations.

PART III
EVOLUTION AND TENDENCIES

CHAPTER XIII

CHANGING CONDITIONS AND EMERGING ISSUES

Part I of this study contains an analysis of the underlying economic and political circumstances that led to the passage of the Agricultural Credits Act of 1923 and the establishment of the Federal Intermediate Credit system. This is followed in Part II by an exposition of the actual functioning of the system in the several fields of our agricultural and livestock industries. In Part III we are to be concerned primarily with the prospects of our rural credit system so far as they can be divined from its previous record and a study of the new problems with which it must cope.

In the present chapter we shall (1) reconsider briefly the assumptions which underlie the original legislation establishing the Intermediate Credit system and contrast these notions with the present conception of its character and functions; (2) examine the difficulties which have been encountered in creating an agricultural banking system; and (3) consider some proposals for change in administrative control which are designed to give the Intermediate Credit Banks greater opportunities for service. The third undertaking involves a consideration of the role the Intermediate Credit Banks are equipped to assume in the agricultural program projected by the Federal Farm Board. This relationship, however, is sufficiently separate and important to demand rather full discussion in a chapter of its own. Following that we shall in the closing chapter make an appraisal of the work of the Intermediate Credit system and attempt to evaluate

the place which the system should permanently occupy in our financial structure.

I. THE CHARACTER OF THE FEDERAL INTERMEDIATE CREDIT SYSTEM

The proponents of the Intermediate Credit Banks proceeded upon the theory that our commercial banking system is not adapted to granting credit on such terms as agriculture requires. In the first place, they asserted that the credit which the farmer needs for purposes of production and marketing should run for nine to twelve months or even longer. Commercial banks cannot always grant these maturities with safety, for their loan resources depend upon the volume and stability of customers' deposits, which in practice are largely demand liabilities. If, in order to meet the demand of its depositors, a bank must restrict its loans, it has no other alternative than to refuse to renew some of them as they fall due. During normal times commercial banks can meet the farmers' needs for longer maturities by frequent renewals of short-term notes. But a shrinkage in deposits, particularly if it coincides with increasing difficulty or expense of borrowing from correspondent banks or Federal Reserve Banks, often forces the farmer to liquidate his loan under conditions that appear to him to be inopportune. In periods of general liquidation, accompanied by numerous bank failures such as occurred in 1920-21, farmers with ample collateral frequently are forced to pay their loans before they are liquidated in the normal course of production.

It was believed that under the Intermediate Credit system it would not be necessary for agriculture to suffer unduly from local or general credit stringencies. Not only could the Intermediate Credit Banks make loans

for maturities of six months to three years but, since their loan resources were unaffected by depositors' claims, they could discount acceptable paper in quantities limited only by their capital resources and their ability to sell their securities in the open market. So long as there were funds looking for investment opportunities, the Intermediate Credit Banks could, through the sale of debentures, direct these funds into agricultural channels.

As the Intermediate Credit system has evolved, however, the original conception of its character and functions has been modified. The amendment of June 26, 1930 which authorized the Intermediate Credit Banks to make loans of any maturity not to exceed three years removed the artificial legal distinction which the Agricultural Credits Act originally made between short-term and intermediate credits. But although the Intermediate Credit Banks are allowed to make loans with maturities of three years, in practice crop production loans are drawn to mature at harvest time and livestock loans run for six, nine, and occasionally twelve months with frequent renewals, while direct commodity loans usually run less than six months. The borrower's credit status is re-examined at frequent intervals as a condition to renewal. Obviously this practice continues the uncertainty regarding renewals of which agriculture has always complained, but if curtailment of credit comes now, it does so as a result of impairment of the borrower's position rather than of shrinkage of deposit funds.

As the distinction between commercial credits and loans of intermediate maturities ceased to have any significance, officers responsible for the administration of the Intermediate Credit system and those who use its facilities have come to regard it not so much as a type of

credit institution essentially different from commercial banks, but rather as a commercial banking system adapted and developed for agricultural industries. The idea of an *intermediate credit* system has given way to that of an *agricultural credit* system. The Intermediate Credit Banks and the local credit corporations serve as a commercial banking system for agriculture and not merely as credit institutions to fill a gap between commercial banks and mortgage banks.

The case for a separate commercial banking system for agriculture is more easily defended now than it was at the time the Agricultural Credits Act was passed. It has long been apparent that under our system of unit banks some mechanism is required to connect capital deficit areas with surplus funds in other localities. Speaking generally, agricultural sections have always constituted the deficit areas, but, during the period in which the Intermediate Credit Banks have been finding a place in our credit structure, two circumstances have tended to accentuate the credit deficit position of much of our agricultural area. In the first place, there has been a sharp curtailment of commercial banking facilities in rural areas during the past decade. A succession of years marked by hundreds, indeed thousands, of bank failures in agricultural sections has enlarged the areas in which bank capital and deposits are insufficient to meet the local demands for loans. In the second place, the loan and investment policies of commercial banks of deposit have been undergoing modifications which accentuate the scarcity of funds in rural areas.

Even in those communities in which deposits continue to expand, a declining portion of earning assets is made up of commercial loans. Although it is impossible to measure the extent to which agricultural producers suf-

fer by the tendency of banks to increase their investment accounts and their loans on securities and real estate at the expense of their other loans, it is apparent from the

LOANS AND INVESTMENTS OF COUNTRY MEMBER BANKS, 1925-32*
I. In Millions of Dollars

June 30	Loans			Investments	Total Loans and Investments
	Securities ^b	Real Estate	All Other ^c		
1925.....	1,586	1,036	5,209	3,996	11,827
1926.....	1,779	1,175	5,365	4,138	12,458
1927.....	1,934	1,270	5,176	4,432	12,812
1928.....	2,245	1,384	5,128	4,765	13,522
1929.....	2,480	1,486	5,129	4,624	13,719
1930.....	2,367	1,475	4,762	4,554	13,157
1931.....	2,078	1,437	3,998	4,555	12,068
1932.....	1,574	1,328	3,112	4,226	10,240

II. Percentage Distribution

1925.....	13.4	8.8	44.0	33.8	100
1926.....	14.3	9.4	43.1	33.2	100
1927.....	15.1	9.9	40.4	34.6	100
1928.....	16.6	10.2	37.9	35.2	100
1929.....	18.1	10.8	37.4	33.7	100
1930.....	18.0	11.2	36.2	34.6	100
1931.....	17.2	11.9	33.1	37.8	100
1932.....	15.4	12.9	30.5	41.2	100

* Data are compiled from *Annual Reports of the Federal Reserve Board*, 1928, p. 118; 1929, pp. 92-93; and from *Federal Reserve Bulletin*, August 1932.

^b Loans to brokers and dealers in securities in New York City and loans to banks secured by stocks and bonds are included.

^c "All other loans" includes all loans except those classified as secured by stock market collateral or real estate. Commercial paper and bankers' acceptances are included. There is no satisfactory way to isolate agricultural loans from this total.

accompanying table that this policy is encroaching upon the proportion of funds available for agricultural production and marketing.

On June 30, 1932 only 30.5 per cent of the total

loans and investments of country member banks represented loans which were not secured by stocks and bonds, or by real estate. In the short period of seven years since June 30, 1925, investments increased from 33.8 per cent of the total earning assets to 41.2 per cent; loans on securities increased from 13.4 cent to 18.1 per cent in June 1929, with a drop to 15.4 per cent in June 1932; while "all other" loans declined steadily from 44 per cent to 30.5 per cent. As a result of this change in the composition of earning assets, agricultural borrowers are faced with a gradual curtailment of accommodation from their local banks. More than ever they are in need of a banking mechanism that will give them access to outside money markets.

The condition of chronic distress in agriculture since 1920 is responsible in part for these changes in loan policies of commercial banks. Declining land values have left many farmers without any equity in their farms, and extremely low prices for agricultural products have reduced the incomes out of which loans are liquidated. Although current advances can be adjusted in accordance with changing conditions, rural banks cannot obtain a suitable geographical distribution of risks, and they dare not concentrate a large fraction of their loans in an industry which is faced with the prospect of a long period of readjustment.

The Intermediate Credit Banks obtain a geographical distribution of risks that is impossible for commercial banks, and the system as a whole secures a wide distribution of risks within all branches of the agricultural and livestock industries. Moreover, these banks finance the distribution of farm products as well as the more hazardous production programs, which is not true of the average rural commercial bank. Although the Intermediate

Credit Banks probably observe stricter credit requirements than local commercial banks, their freedom from the demands of depositors allows them more latitude in their renewal policies, while the pooling of earnings throughout the system enables individual banks to share the risks of local disasters with banks in other sections of the country.

Thus the case for the Intermediate Credit Banks today runs less in terms of longer maturities or temporary credit stringencies and more in terms of the desirability of developing an agricultural banking system to replace commercial banks of deposit as the main source of agricultural loans. If the Federal Farm Board succeeds in organizing the various branches of our agricultural industries on a co-operative basis, along national rather than local lines, these co-operatives will look to the Intermediate Credit Banks for credit accommodations. This would foreshadow a more pretentious role for the Intermediate Credit Banks. Just what working arrangements may be evolved, and the terms on which the Intermediate Credit Banks can co-operate, are discussed in the succeeding chapter. It suffices at this point to note that the need for a separate banking system for agriculture which will relieve commercial banks of an obligation which they are increasingly reluctant to meet is more generally conceded now than at any previous time.

Many farmers and their political spokesmen are disposed to assign to the Intermediate Credit Banks the role of banker for those branches of the agricultural industry or those members of it that are not acceptable risks for commercial banks. This tendency to disregard the strictly banking character of the Intermediate Credit Banks and to look upon them as emergency institutions rather than a permanent banking system for agriculture persists in

spite of the fact that the Farm Loan Board consistently opposes all proposals that would force them to serve in the capacity of emergency relief agencies.

Recurring disasters affecting large agricultural areas, however, bring pressure upon the system to aid in such emergency situations. Floods, storms, droughts, and severe declines in agricultural prices invariably revive agitation for emergency credit measures to assist in rehabilitating distressed areas or to carry unsold commodities.¹

But in its annual report of 1930 the Farm Loan Board states that the land banks and the Intermediate Credit Banks "are not in a position to act as emergency relief institutions, and it is the view of the Board that relief, as such, that is, assistance that reached beyond the domain of sound loans into the realm of doubtful loans and the like, should be extended through channels other than the banks of the farm loan system."

The Intermediate Credit Banks themselves are equally emphatic in rejecting suggestions that they furnish "farm relief." Because of the general misunderstanding of the conditions under which they can make loans, the Wichita Bank in a recent bulletin attempted to clarify the situation. It reminded the public that:

The Intermediate Credit Bank of Wichita is a bank and is not a reservoir from which government or other funds may

¹ See report of banker members of the State Drought Relief Committee adopted Aug. 27, 1930, published in full in *U. S. Daily*, Aug. 28, 1930.

M. E. Bristow, state commissioner of banking and insurance, Richmond, Va., reported that those most in need of drought relief would not be able to offer acceptable collateral. He suggested that the federal government make available a sum of money through local banks or the Federal Intermediate Credit Banks. Local banks were not expected to act as guarantors for such loans. The same, Aug. 16, 1930.

be drawn and disbursed to the unfortunate and the needy no matter how worthy their claim to public charity.

There is no more reason to expect that the Federal Intermediate Credit Bank of Wichita will pay money for the note of an insolvent farmer, secured only by the hope that he may make a crop next year, than there is to expect that the Federal Reserve Bank of Kansas City will pay money for the note of a laborer out of a job, secured only by the hope that he may get a job next year. . . .

If there is nothing with which the loans desired can be fully secured, then the Federal Intermediate Credit Bank cannot help, and folks who have suffered misfortune and grievous losses should not be misled.²

In spite of numerous official statements in this vein, the Intermediate Credit Banks are regularly cited by those demanding relief for agriculture as institutions well adapted to distribute funds to farmers without bankable paper.

The only emergency role that Intermediate Credit Banks can perform is that of supplementing or replacing commercial banking facilities when local disasters make it imperative to draw upon outside funds. The crisis affecting the Louisiana sugar industry in 1925, the distress in livestock areas in 1921-25, and the numerous bank failures in recent years are cases in point. Even so, all loans must be well secured and indorsed by responsible financing institutions before they are acceptable as security for debentures to be sold in the open market. Banks which look to the investing public for funds must remain conspicuously aloof from relief programs conducted on any principle not approved by sound banking practice. If the agricultural and livestock industries de-

² "Intermediate Credit Bank's Functions," *The Financing of Farming*, September 1930. (Published by the Federal Land Bank and the Federal Intermediate Credit Bank of Wichita.)

sire the advantages of lower interest rates and a dependable source of credit they cannot at the same time offer paper that exposes the system to unusual hazards. Any tendency to confuse emergency relief activities with the functions of an agricultural banking system will inevitably react unfavorably upon the credit of the Intermediate Credit Banks.

But even those who have no desire to foist extra hazardous loans upon the Intermediate Credit Banks and who expect them to function according to conservative banking practices feel that the banks fall short of their maximum possibilities of financing normal agricultural operations. These critics quite often fail to make proper allowances for the difficulties under which the Intermediate Credit Banks operate and misjudge the length of time it takes to construct a banking system to serve a basic industry such as agriculture.

II. DIFFICULTIES ENCOUNTERED IN CREATING AN AGRICULTURAL BANKING SYSTEM

Serious obstacles have delayed and to some degree effectively prevented the development of a satisfactory agricultural banking system. The chief difficulties arise from the following sources: (1) weaknesses in the local credit mechanism which connects the individual borrower with the discounting banks; (2) insufficient latitude in respect to operating margins for the Intermediate Credit Banks themselves and also for the local discount corporations; and (3) the reluctance of the Intermediate Credit Banks to compete vigorously for business.

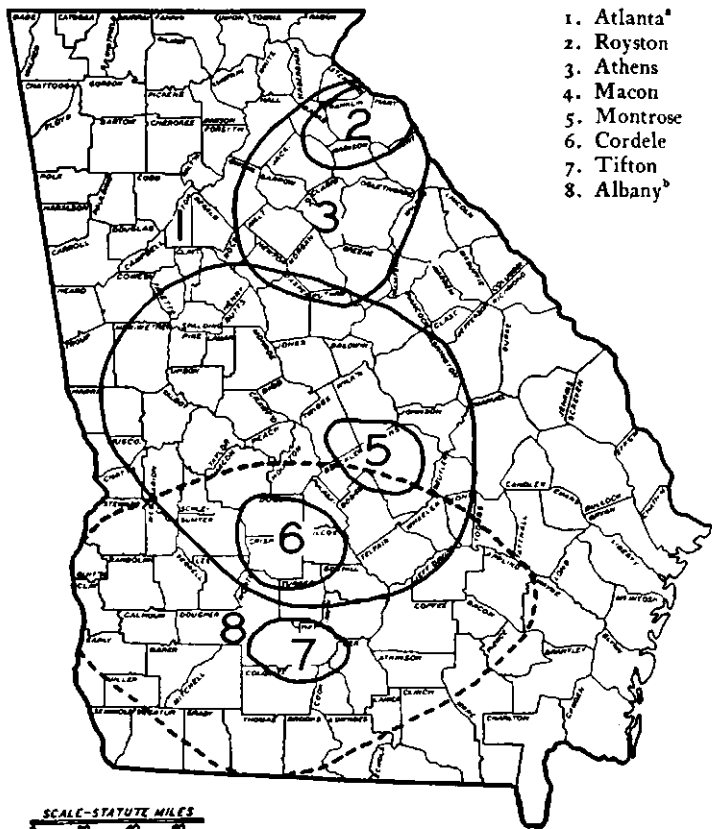
Inasmuch as the Intermediate Credit Banks cannot loan directly to individuals, they cannot serve effectively as a discount system for agriculture in the absence of suitable financing institutions to originate loans. Congress apparently assumed that existing commercial banks

would connect borrowers with the Intermediate Credit Banks. But, as we have seen, banks discount very little paper directly, and thus far have played a minor part in organizing agricultural credit corporations.

Livestock loan companies and agricultural credit corporations have developed in a most disorganized fashion. As a result of the indiscriminate chartering of credit corporations by 48 different states, their ill-considered alliances with a wide variety of business and commercial interests, and the difficulty of raising sufficient capital and keeping it intact, discounts have originated with a succession of financially irresponsible credit institutions incapable of rendering continuous service to borrowers and unable to safeguard the Intermediate Credit Banks against loss. These structural defects must be remedied before the Intermediate Credit Banks can function effectively as a central discount system for agriculture.

The present unregulated freedom to organize credit corporations cannot be tolerated if satisfactory local facilities are to be available for farmers. A charter can be obtained without any proof of the economic necessity for additional credit facilities in the community. Competing corporations are authorized to serve a territory which affords only sufficient business to justify one loan company. This multiplication of facilities not only perpetuates the worst evils of our system of small independent banks but necessitates the expense of examining and scrutinizing the paper of hundreds of short-lived credit corporations whose annual volume of business is often less than \$100,000. The planlessness of the present system is well illustrated in the maps on pages 320 and 322, which show the territorial boundaries of the agricultural credit corporations placing crop loans in Georgia, and of livestock credit corporations in South Dakota.

LOAN TERRITORIES OF AGRICULTURAL CREDIT CORPORATIONS IN GEORGIA, 1930



^a The credit corporation with headquarters at Atlanta is a subsidiary of the Georgia Cotton Growers' Co-operative Association and operates throughout the state although very few loans are placed in the south-west portion of the state.

^b The credit corporation at Albany whose boundary is marked with a broken line is in liquidation and made no new loans in 1930.

In 1930 seven agricultural credit corporations in Georgia rediscounted \$1,589,000 of crop production loans. The largest of these loan companies, the Growers' Finance Corporation, is a subsidiary of the Georgia Cotton Growers' Co-operative Association, which operates throughout the state although the bulk of its business is within the central portion. The controlling interest in the second credit corporation which served the central section of the state is held by a fertilizer concern. Approximately 80 per cent of all the crop production loans discounted from Georgia in 1930 were made by these two corporations, and each sold fertilizer to borrowers. Five other credit corporations, which originated only 20 per cent of the discounts, confined their activities to much smaller areas, and in 1930 none rediscounted more than \$100,000. The four smallest corporations were affiliated with commercial banks, and each financed from 50 to 100 producers in its immediate community.³

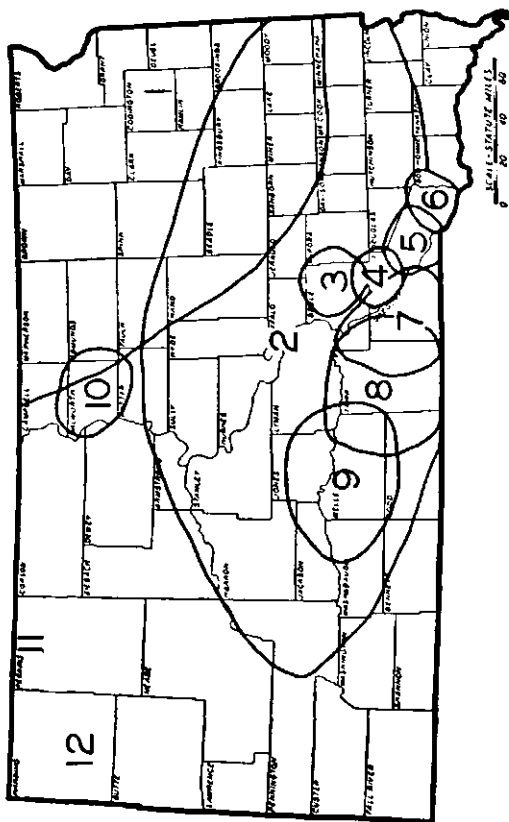
A similar overlapping of loan territories and duplication of effort occur in the North Central livestock sections where bank failures have deprived large areas of their commercial banking facilities. The map on page 322 shows the territorial boundaries of ten South Dakota corporations which specialize in loans to the small livestock producers.⁴ Together they had rediscounts out-

³ Until the 1930 crop season the southern third of the state was served by a credit corporation which had no official affiliation with any bank or commercial enterprise. At one time this corporation loaned more than a million dollars annually over a radius of 150 miles, but by 1930 its capital was so impaired that no new loans were made except as small advances were made in the hope of reducing losses.

In 1931 and 1932 a number of new credit corporations were created, and the proportion of business handled by each corporation is materially changed.

⁴ Two corporations with headquarters in Harding and Perkins Counties respectively serve the range area of South Dakota and adjoining

LOAN TERRITORIES OF LIVESTOCK CREDIT CORPORATIONS IN
SOUTH DAKOTA, 1930



- | | | |
|----------------|---------------|--------------------------------------|
| 1. Watertown | 5. Lake Andes | 9. White River |
| 2. Sioux Falls | 6. Wagner | 10. Selby |
| 3. Kimball | 7. Gregory | 11. Lemmon (boundary not indicated) |
| 4. Platte | 8. Winner | 12. Harding (boundary not indicated) |

standing of 1.8 million dollars on August 30, 1930, but only four of the ten which originate three-fourths of all the loans had rediscounted more than \$250,000. Some effort has been made to consolidate corporations which have no chance to develop a profitable volume of business with stronger corporations in the vicinity, but in general they operate without let or hindrance over whatever area they choose to serve.

Credit corporations not only set their own territorial limits but are free to form alliances with all kinds of commercial and business enterprises. As a result the influence of the Intermediate Credit Banks in maintaining credit standards is largely negative. They may refuse discount privileges or reject specific offerings, but thus far they have taken no active part in the organization of financially responsible credit corporations conducted by competent managers. Since the indorsement of the credit corporation, supplemented at times by the indorsement of the parent organization, supposedly guarantees the redemption of discounts at maturity, discount privileges are granted with considerable care. In the beginning no one anticipated an extensive development of credit corporations quite outside the jurisdiction of our commercial banking system. Very early the Farm Loan Board announced that in its opinion country banks were the most satisfactory points of origin for discounts.⁵ Only if they failed to act were independent credit corporations to be organized. In practice, however, loans originate with several hundred credit corporations, only a few of which

states but the exact boundaries of their territories are not given in this map.

⁵ Merton L. Corey, Federal Farm Loan Board, "The Agricultural Credits Act of 1923," *Proceedings of the Missouri Bankers' Association*, May 22-23, 1923, p. 67.

are affiliated with commercial banks. Others are subsidiaries of co-operative marketing and purchasing associations, and still others are operated as adjuncts to a wide variety of profit-making business enterprises.

Just what principles should guide the Intermediate Credit Banks in granting discount privileges, and under what auspices credit corporations can best operate, are matters of dispute. But if the Intermediate Credit Banks are to discount paper freely they must be assured of (1) the absence of any conflicting interests which place a premium on lax credit practices, and (2) the financial responsibility of the indorser. A third issue is raised whenever discount privileges are granted to business interests that are indifferent or antagonistic to co-operative marketing.

Co-operative marketing associations are convinced that they and their members should be the chief beneficiaries of the Agricultural Credits Act. They maintain that

the only justification for the Intermediate Credit Act is that it is intended for the relief of producers and not of brokers. It presumably was a farmer-inspired bill and should be so interpreted and its provisions should not be available to those who seek to parcel out production credits with usurious arrangements and with hostile marketing of the mortgaged property.⁶

But, regardless of the source of inspiration of the legislation, the Agricultural Credits Act as it was passed affords no basis for holding that funds must reach producers only through the medium of agencies affiliated with or even sympathetic toward co-operative marketing.

Any preferences which the Intermediate Credit Banks

⁶ Fred J. Elliott, "Control of Affiliated Processing Corporations," *American Co-operation*, 1929, p. 472.

show in determining the channels through which funds reach agricultural producers must be for the purpose of insuring the elimination of undesirable loans. It is quite evident that all sponsoring groups are not equally alert to reject doubtful credit risks or equally capable of honoring their indorsements on discounted paper. When discounts originate with business interests, the control of production credit is in the hands of those who expect to profit from an increased volume of business rather than from the credit transaction itself. Inevitably the problems of supervision and the maintenance of credit standards become more difficult. There is a constant temptation to sacrifice credit standards in the interest of trading profits.

Co-operative associations are likewise interested in commissions and profits from the sale of supplies, but they have less incentive to finance doubtful applicants with the expectation of recouping credit losses through ample trading margins. Their commissions for services cannot exceed the charges of their competitors if they expect to maintain deliveries, and their affiliated supply companies are likely to quote attractive prices for farm supplies as an inducement for producers to join the association. Moreover, profits of co-operative supply companies are ordinarily distributed in the form of patronage dividends, and so the temptation to relax credit standards for the purpose of increasing profits is removed. The experience of certain Intermediate Credit Banks leads them to believe that co-operatives are less likely to approve doubtful risks than are business groups and that constant vigilance is necessary to prevent the latter from sacrificing safety of loans for an increased volume of business.

It would seem that maintenance of acceptable credit

standards would be enormously simplified if all discounts originated with credit corporations affiliated with commercial banks. Ordinarily commercial banks are operated by men who are familiar with the business affairs of applicants. They rarely engage directly in mercantile pursuits but derive their income from loans, which circumstance reduces the likelihood of deliberate overlending. The Intermediate Credit Banks have access to the reports of state and national bank examiners and are entirely free to refuse a line of credit if an affiliated bank is in serious financial straits which might prompt it to recommend doubtful loans. By costly experiment the Intermediate Credit Banks have learned to curtail discounts whenever the financial investment of the sponsoring bank is too small to command the best efforts of its officers in rejecting inadequately secured paper. Nevertheless the frequency with which commercial banks have attempted to transfer undesirable paper to the Intermediate Credit Bank through affiliated credit corporations has made them unsatisfactory as sources of discounts.

Commercial banks may be more acceptable connections for agricultural and livestock credit corporations later than they have been up to the present time. The high mortality among country banks since 1923 and the efforts of state and national bank authorities to consolidate surviving banks should eliminate the weakest institutions. When this purging process is complete our commercial banking system may offer a stronger foundation upon which to build a rural credit system. The process will certainly leave many desirable customers of defunct banks without their usual banking connections. If the Intermediate Credit Banks succeed in convincing financially strong commercial banks of the advantages

which accrue to them by exercising their discount privileges, the system will have more dependable points of origin for loans and producers will find Intermediate Credit funds more accessible.

If the Intermediate Credit Banks grant discount privileges only upon a showing of ability and willingness to conform to credit policies approved by them, they will be forced to discriminate against credit corporations sponsored by business enterprises if the desire for larger profits from business transactions encourages lax credit policies. This does not mean that credit affiliates of business enterprises need find it difficult to secure discount privileges. Business interests which retain competent credit managers and extend credit to producers on a conservative basis will be entitled to accommodation since the Agricultural Credits Act does not stipulate that the Intermediate Credit Banks are for the exclusive use of co-operatives.⁷ Such a policy would, however, make it difficult for independent business men to organize credit corporations in the hope of supplementing their personal incomes, or for small business concerns to incorporate their credit departments and qualify for discount privileges.

Agricultural credit corporations and livestock loan companies have appeared and vanished with disconcerting frequency throughout the period the Intermediate Credit Banks have been in operation. It is only recently, however, that any governmental aid has been forth-

⁷ If the Intermediate Credit Banks deem it advisable to require affiliated concerns to indorse with the credit corporation, the financial resources of many business concerns will make their paper more acceptable than loans indorsed by credit affiliates of non-stock co-operatives or small commercial banks. For instance, the indorsement of the United Fruit Growers, Inc., or similar commercial firms, insures the Intermediate Credit Banks against carry-over paper.

coming to build up a more adequate local credit structure. In 1925 livestock producers urged the federal government to furnish the necessary capital for livestock credit corporations but no action was taken. The Farm Board is now devoting a portion of its funds to organizing credit corporations designed to give producers access to the Intermediate Credit Banks, but this phase of its activities is quite incidental to its major objective of setting up a co-operative distributing system for agriculture.⁸

In 1931, as a part of its program to afford relief to the drought and hail areas, Congress authorized the Secretary of Agriculture to make loans to individuals in these areas for the purpose of assisting in the formation of local credit corporations or of enlarging the resources of credit corporations already in existence.⁹ As might be expected, similar legislation was proposed the following year. A joint resolution of Congress was approved on March 3, 1932 which provides for a 10 million dollar revolving fund to aid in the establishment of loan companies to discount with the Intermediate Credit Banks. The resolution provides:

⁸ See Chap. XIV for a detailed discussion of the efforts of the Federal Farm Board to organize agricultural and livestock credit corporations to discount with the Intermediate Credit Banks.

⁹ Under the authority of an Act of February 14, 1931 (Public No. 666) 20 million dollars was appropriated to be used in making loans to individuals for the purpose of aiding in the formation of agricultural and livestock credit corporations or strengthening the capital structure of existing corporations. To Jan. 15, 1932 the Department of Agriculture had loaned \$1,421,035 to 936 individuals in 21 states for the purchase of stock in 50 agricultural credit corporations.

Arkansas had made funds available for a similar purpose, and by Dec. 8, 1931 had loaned \$874,355 for the purchase of stock in 60 agricultural credit corporations. Mississippi authorized such loans but no advances had been made at the close of 1931. *Annual Report of the Federal Farm Loan Board*, 1931, p. 53.

That the Secretary of Agriculture is hereby authorized to make advances or loans to individuals under such regulations as he may prescribe, for the purpose of assisting in forming local agricultural credit corporations, livestock loan companies, or like organizations, or of increasing the capital stock of such corporations, companies, or organizations qualified to do business with Federal Intermediate Credit Banks, or to which such privileges may be extended.¹⁰

Inasmuch as the fund is a revolving one and loans are not confined to specified distressed areas, Congress evidently contemplates a more helpful attitude on the part of the federal government in setting up credit corporations which will connect producers with Intermediate Credit Bank funds.

Whether this provision for active assistance on the part of the federal government by means of capital stock loans will result in further developments of any consequence is extremely doubtful. Since the 10 million dollar loan fund was provided, the Reconstruction Finance Corporation has been authorized to establish regional agricultural credit corporations in each Federal Land Bank District with a minimum paid-in capital of 3 million dollars, all of which is supplied by the federal government. If reasonable efforts are made to utilize this larger fund to provide credit corporations which loan directly to agricultural producers, there is little reason to believe that for the present individual farmers will borrow from the government to furnish capital for small local credit corporations.¹¹

¹⁰ 72 Cong., pub. res. No. 11 (H.J. res. 292).

¹¹ The minimum amount that can be borrowed from the Department of Agriculture fund is \$500 and, since only 60 per cent of the par value of the stock will be loaned, only individuals prepared to invest nearly \$350 in cash are eligible for loans. Consequently advances are apt to be limited to a few bankers or business men and to large operators whose annual credit requirements are considerable.

Nevertheless the regulations under which the Department of Agriculture proposes to administer this loan fund are significant inasmuch as they attempt to avoid some of the errors which have been responsible for many of the failures of earlier credit corporations. In general these regulations are conservative, and are designed to offer protection to both borrowers and the Intermediate Credit Banks. Loans are made to individuals who wish to buy stock for their own account and not to credit corporations directly or to banks, co-operatives, or other incorporated business organizations. Although the resolution authorizes loans equal to 75 per cent of the value of the capital stock pledged as security, the regulations stipulate that only 60 per cent of the par value shall be advanced. The balance must be paid in cash. It is hoped that this cash investment will give sufficient local participation to insure competent and conservative management.

No loans are to be made on the stock of credit corporations which will have paid-in capital of less than \$50,000, for it is believed that a volume of business of \$200,000 or \$250,000 is essential to provide sufficient income to pay expenses.¹² The proceeds of all loans are transferred to the Intermediate Credit Banks to be invested in securities to guarantee a line of credit, and the

Inasmuch as the Reconstruction Finance Corporation is an emergency institution, the credit corporations which it sets up are presumably temporary organizations while the Department of Agriculture fund finances permanent facilities. There is no reason, however, that the regional credit corporations cannot be continued if they prove successful and a demand for their services persists.

¹² This minimum is not too high for independent credit corporations, but it may force the organization of a separate corporation when the needs of the community could be met more economically by a credit subsidiary of a local bank with a smaller capital investment.

interest from these securities is to be a guarantee that the interest on the government loan will be paid.

Loans are to be made only after a thorough investigation of the borrower's financial status and of the ability of the prospective management of the corporation, and only after receiving proof that additional credit facilities are needed in the community and that the credit corporation has a reasonable expectation of functioning without impairing its capital. Although merchants, bankers, and other business men may borrow to purchase stock, the credit corporation must follow "a policy of making its funds available to farmers under conditions that, in the judgment of the Secretary of Agriculture, are not detrimental to the borrowers' best interests."¹⁸

The danger of imposing upon new applicants who might be asked to purchase stock in an existing credit corporation whose capital was already impaired was recognized and loans will not be made until the financial status of the credit corporation has been approved. Quite often the interests of borrowers are endangered because those who originally sponsor the corporation, and who are responsible for loan policies and collections, have very little financial stake in the enterprise. This danger is avoided in part by requiring that if any stock is retired it must be acquired ratably from all stockholders. Consequently promoters who contribute to the capital investment are not at liberty to avoid later losses by retiring their holdings after a sufficient amount of stock has been distributed to borrowers.

Without minimizing the difficulties of obtaining suf-

¹⁸ *Regulations for Loans for Capitalizing Agricultural Credit Corporations or Livestock Loan Companies*, U. S. Department of Agriculture, July 21, 1932.

ficient capital to provide local credit corporations, or questioning the wisdom of these regulations and the wholesome effect of careful supervision of credit corporations by the Secretary of Agriculture, it should be recognized that the practice of making loans on the security of capital stock of hundreds of small financing institutions introduces points of friction and serious moral hazards which expose the Intermediate Credit Banks to chances of serious losses. When a substantial percentage of the original capital is supplied through government loans, local responsibility is reduced, thus weakening the incentive for conservative management. Moreover, the earning capacity of a majority of agricultural credit corporations and livestock loan companies has not proved sufficient to cover expenses and carry the interest charges on these loans without precluding the possibility of establishing adequate reserves for losses.¹⁴

If the government expects to preserve the revolving character of this fund, advances to borrowers must be kept well within an amount that will insure payment of their loans as well as of the indebtedness on their capital stock. The extremely conservative loan policies which this will necessitate will be a source of irritation from the outset. Furthermore, capital stock loans are for one year only and, unless they can be liquidated out of receipts from current operations, the moral hazards become serious. Borrowers who find that they cannot pay in full, and who face the possibility of being unable to qualify for loans the following season, have a strong incentive to salvage their small cash investment in the credit corporation by evading payment in full and allow-

¹⁴ A rate of 5.5 per cent is charged on these capital stock loans, and it is quite unlikely that the securities in which the proceeds are invested will yield more than 3 per cent.

ing the government to liquidate the loans on capital stock by realizing on the security pledged. Since this is often impossible without liquidating the corporation itself, the government may find itself with a large permanent investment in numerous credit corporations throughout the country. An outright investment in the first instance is preferable to this indirect procedure of acquiring stock by means of loans to individuals.

It is a fundamental error to assume that under present conditions stock purchases in agricultural credit corporations or livestock loan companies are investments that can be expected to yield a cash return sufficient to cover the cost of borrowed funds at current rates of interest. Admittedly the sale of stock to borrowers is a device to share the costs of operation with those who expect to benefit from loan services. At present, capital contributions of borrowers resemble permanent, non-interest bearing, and non-transferable deposits which presumably entitle them to borrow so long as their collateral is acceptable and the corporation continues to operate. Unfortunately these deposits often cannot be preserved intact and continuity of operations is highly uncertain because of the short-sighted attempts to render an expensive loan service at rates that do not yield sufficient revenues to place the system on a profitable and therefore a stable basis.

Improvements in the local credit machinery will not enable the Intermediate Credit Banks to serve agriculture adequately unless their own operating income as well as that of the credit corporations for which they discount loans is sufficient to cover expenses, including ample reserves for all contingencies. Any attempt to expand rapidly on any other basis is fraught with serious danger to any system of rural credits. In its efforts to re-

duce interest rates to agricultural borrowers Congress disregarded this fundamental principle and has handicapped the Intermediate Credit system at every point with narrow and inflexible operating margins.

The Intermediate Credit Banks are required by law to make all their advances on an operating margin of 1 per cent, while local credit corporations are limited to a 3 per cent spread above the discount rate without regard to the character of the underlying collateral, the risks assumed, or the costs of doing business. These restrictions do not interfere materially with direct loans to co-operative marketing associations, but they may cripple permanently the growth of discounts.

The 1 per cent margin for direct loans is a reasonable operating spread if the loans are secured by wheat, cotton, or wool. Such advances are made to 15 or 20 statewide or regional co-operatives whose requirements usually range from \$500,000 to several million dollars annually.¹⁵ These loans are highly liquid, for the commodities pledged have a continuous market and are moving into channels of consumption. Loan margins must of course be more ample in periods of rapidly fluctuating prices, for a 1 per cent spread assumes that no avoidable risks will be taken. Probably an operating margin of 1 per cent is quite adequate for loans secured by such crops as raisins, rice, olive oil, and canned fruits, if the loans are carefully made and well margined. Extreme declines in the prices of crops which can be liquidated only slowly may result in occasional losses, but these ordinary losses can be met out of earnings if franchise

¹⁵ The actual number of associations borrowing from the Intermediate Credit Banks has been reduced as a result of the efforts of the Federal Farm Board to combine state and regional associations into national selling organizations.

taxes are waived until adequate reserves are accumulated to absorb any extraordinary losses. Moreover no Intermediate Credit Bank is mainly dependent for its income upon loans secured by non-staple crops. In every district most of the loans are secured by cotton, wheat, or wool and mohair, which involve a minimum of risk.

Discounts are probably more hazardous than direct commodity loans and certainly they are more expensive to handle. Even so, the Intermediate Credit Banks are required to discount farmers' notes on the same 1 per cent margin allowed for direct loans to co-operatives. Although the Intermediate Credit Banks are not profit-making institutions, their operating spread should be commensurate with their costs of doing business. Instead, they are expected to discount thousands of small agricultural and livestock loans which originate with hundreds of credit corporations having limited financial responsibility and varying degrees of managerial competency on a margin no wider than the commission for acceptance credits, which are conceded to involve negligible risks.

If the system is considered as a unit, the Intermediate Credit Banks have managed to operate on a 1 per cent margin and to accumulate a small surplus. It is quite likely, however, that discounts, particularly crop production discounts, have been subsidized by direct loans. Since neither income nor expenses of the Intermediate Credit Banks are allocated between commodity loans and discounts, there is no conclusive evidence that discounts are carried at a loss, but an examination of the earnings of the several banks and the statements of administrative officers leave little doubt that direct loans do carry a disproportionate share of the joint costs. This subsidy of

high-cost business is objectionable even if earnings are sufficient to continue it indefinitely. The debentures of a banking system which is compelled by law to conduct a substantial fraction of its business at a rate so low that it cannot make adequate provision for losses are likely to suffer in competition with other securities in the investment market. Moreover, co-operatives object to this pooling of earnings because the benefit from artificially low discount rates accrues to members and non-members alike. This objection may be withdrawn if a majority of the farmers in a district belong to some co-operative organization which contributes to the income of the Intermediate Credit Banks, but at the present time there is no disposition on the part of co-operatives to approve this practice of permitting profits from loans to co-operative marketing associations to cover a portion of the cost of discounting producers' notes.

Not only are discounts less profitable than commodity loans for the Intermediate Credit Banks, but the 3 per cent operating spread allowed the local financing institutions is a serious obstacle to the development of a substantial volume of business originating with well-financed credit corporations. Although the indorsement of credit corporations is supposed to relieve the discounting bank of any risk of loss, inadequate revenues effectively prevent a majority of the corporations from absorbing their own unavoidable losses. The 3 per cent margin recently approved by the Farm Loan Board may enable livestock credit corporations with a large volume of high-grade loans to operate at a profit. Nevertheless the present policy of uniform operating margins for all discounts regardless of the size of the loan, the underlying security, or the cost of placing and supervising

them, is quite indefensible. Especially in the case of crop production loans a gross margin of 3 per cent is most absurd. Probably a frank recognition of the actual costs of conducting a crop loan business, followed by permission from the Farm Loan Board to charge rates in accordance with these costs, is politically impracticable. Interest costs ranging from 15 per cent to 28 or 30 per cent would be inevitable in many cases, and such charges would raise a storm of protest that no government owned banking system is prepared to face. Attempts to justify these costs by drawing comparisons between them and the legal rates of 3 per cent per month for small industrial and personal loans would neither convince nor appease an agricultural constituency.

Rather than admit the unpleasant truth that the Intermediate Credit system has not devised a way to finance hazardous crop loans at rates which the borrowers acknowledge to be reasonable, the discounting banks must insist that agricultural credit corporations confine their loans to a negligible number of highly selected credit risks. If the system is to be operated on margins that are in keeping with superior credit risks there is no choice except to reject more hazardous loans. But if the Intermediate Credit Banks are ever to function in the interest of more than a few thousand producers, they must be allowed enough latitude in approving interest rates or authorizing supplementary charges to make the operating income of credit corporations commensurate with the costs involved. It is patently absurd to attempt by legislative means to equalize interest rates throughout all agricultural areas and in every branch of an industry as varied as the agricultural industry.

A third difficulty which the system faces is the reluc-

tance of the Intermediate Credit Banks to compete vigorously for a larger volume of the more desirable loans. Unfortunately for the rapid expansion of its services a government banking system is charged implicitly, if not expressly, to refrain from interfering with private business. If commercial banking facilities break down or if commercial agencies voluntarily withdraw from the field, government *aid* is welcome; but if profitable business is directed from commercial banks through the efforts of the Intermediate Credit Banks, then government *intervention* is resented. However, unless the Intermediate Credit Banks abandon their hitherto passive role and exploit aggressively the fields which are open to them, they are in fact semi-relief agencies despite their consistent efforts to avoid losses on the loans they do accept. The construction of an effective agricultural banking system is impossible if the local institutions which originate loans are financially weak, if earnings are inadequate, and if the banks refrain from competing for the most desirable business.

None of these defects, however, is inherent in an agricultural banking system or represents permanent weaknesses in the Intermediate Credit system. The haphazard growth of local credit corporations could be avoided if the Intermediate Credit Banks were charged with the full responsibility of chartering them as well as supervising their operations. Even if charters continue to be granted by individual states, the Intermediate Credit Banks could take a more active part in discouraging the multiplication of weak credit institutions and the wasteful overlapping of loan territories. Now that the Federal Farm Board and the Department of Agriculture have funds which can be used to capitalize local credit

corporations, their co-operation with the Intermediate Credit Banks may be expected to expedite and simplify the building up of a more dependable credit structure without interfering with established commercial banks which are serving their communities in a satisfactory manner.¹⁶ An Act of Congress would be necessary to allow the Intermediate Credit Banks to increase their operating margin, but this change will become less necessary if the corporations which originate the loans are allowed operating incomes commensurate with their costs of doing business. The narrow interest spread for discounting institutions, which is the most serious obstacle to extending the services of the system to the average producer, can be modified by administrative action of the Federal Farm Loan Board if the necessity for additional revenue is clearly shown.¹⁷ And, finally, the pressure from all quarters for more aggressive loan service in the interests of farmers and their business organizations will dispel any hesitation to compete for eligible business.

The absence of effective competition for loans on the part of the Intermediate Credit Banks has raised the question as to whether their administration has fallen into unsympathetic or indifferent hands which prevent

¹⁶ It may be seriously questioned whether it is desirable to have the Farm Board and the Department of Agriculture making loans for the purpose of capitalizing agricultural credit corporations at the same time the Reconstruction Finance Corporation is using government funds to capitalize regional agricultural credit corporations.

¹⁷ It might be inadvisable for the Farm Loan Board to abandon its present policy of allowing a uniform spread for all discounts, but sufficient flexibility can be obtained within each district because the regulations of the Board now provide that "the bank or other agency which takes the note in the first instance is not authorized to make any inspection or appraisal charges without the approval of the Federal Intermediate Credit Bank." "Rules and Regulations of the Federal Farm Loan Board to May 20, 1925," *Federal Farm Loan Board Circular No. 15*.

a vigorous development of their services. Is the Farm Loan Board which supervises their operations and formulates their policies sufficiently anxious to develop the system to its maximum usefulness? In short, is the problem of administrative control satisfactorily solved?

III. THE PROBLEM OF ADMINISTRATIVE CONTROL

The original choice of the governmental agency to be entrusted with the supervision of the Intermediate Credit system was largely fortuitous. When the Agricultural Credits Act was drawn up, both the Federal Reserve Board and the Federal Farm Loan Board were considered for the task of administering the system. Since the Federal Reserve Banks were concerned with the extension of commercial credits, the Federal Reserve Board seemed the logical choice. However, agriculture had so consistently regarded the Reserve system with antagonism, especially after 1920, as to make it expedient to install the Intermediate Credit Banks as a branch of the Federal Farm Loan system, although the latter was in no way prepared to supervise the extension of short-term credits. Several objections have been made to this arrangement. Agricultural leaders have been saying for a number of years that the close relationship of the Intermediate Credit Banks with the Federal Land Banks and the Joint Stock Land Banks is a serious handicap to their growth.

Members of the Farm Loan Board as it was originally constituted were appointed because of their familiarity with real estate financing but, when the administration of the Intermediate Credit Banks was assigned to it, three new members were added, one of whom was entrusted with the organization of the new banks. Later a Federal Intermediate Credit Banks Division was set up

within the Federal Farm Loan Bureau. Despite these attentions to the special requirements of the Intermediate Credit Banks there is considerable objection to their connection with the Land Banks. Those who oppose the present set-up believe that a more aggressive and intelligent development of the Intermediate Credit Banks would follow if they were completely divorced from the Land Banks.

The early attitude of administrative officials toward the new system entrusted to their care gives color to these charges of indifference to its development. Although the Farm Loan Board at no time regarded the Agricultural Credits Act as an emergency measure, neither did it consider competition with commercial banks as a part of the Intermediate Banks' functions. In its first annual report after the banks were in operation the Board announced that:

They [the Intermediate Credit Banks] have refused to take loans where the borrowers could be adequately served by commercial banks, to the end that the funds of the Intermediate Credit Banks may be made available to eligible borrowers who cannot be adequately served by commercial banks.¹⁸

Even lower interest rates for farmers were to be obtained "without impairing the legitimate profit which bankers shall receive from their business."¹⁹

This solicitude for the rights and profits of commercial banks has irked agricultural leaders who believe that service to agriculture should be the paramount consideration and that the policy of non-competition with commercial banks is incompatible with this purpose. Although the removal of the minimum maturities per-

¹⁸ *Annual Report of the Federal Farm Loan Board, 1923, p. 4.*

¹⁹ *Corey, Proceedings of the Missouri Bankers' Association, 1923, pp. 67-77.*

mits competition with commercial banks for agricultural loans of any maturity, the Intermediate Credit Banks have not openly reversed their former policy of accepting rather than promoting business.

Another objection to the present arrangement is that the credit of the Intermediate Credit Banks suffers because they are associated in the mind of the public with the Land Banks, some of which have experienced heavy losses. Whether the status of Intermediate Credit Bank debentures is adversely affected by their close affiliation with the Federal Land Banks and the Joint Stock Land Banks is a moot question. Since the Land Banks and the Intermediate Credit Banks are both supervised by the Farm Loan Board the financial difficulties of any bank in either system are reflected in the security market of the others. Furthermore, the same fiscal agent distributes Intermediate Credit Bank debentures and Federal Land Bank bonds. The fortunes of the two systems are thus naturally associated in the minds of investors. And finally, since much publicity has been given to the receiverships of several large Joint Stock Land Banks, it is inevitable that agricultural securities of all types should suffer from these mishaps.

Several proposals have been made to separate the administration of the Intermediate Credit Banks from the Land Banks in the interest of a more wholesome development of the former. The substance of these proposals is to allow the Intermediate Credit Banks their own boards of directors and administrative officers—chosen because they are particularly well qualified to administer short-term loans. The more far-reaching proposals advocate a separate government board to act as a policy-making body and to co-ordinate the activities of the

twelve banks. Although the details of the several amendments offered in Congress vary, their objective is always to establish the Intermediate Credit Banks as a rural credit system in their own right and not as an adjunct to the Land Banks.

The United States Treasury, which contributes the capital of the Intermediate Credit Banks, and the Farm Loan Board oppose any suggestion to set up separate administrative machinery for the Intermediate Credit Banks. Economy of operation is the chief advantage claimed for the present arrangement.²⁰ The overhead expense of an independent supervisory board in Washington and of a separate board of directors, administrative officers, and staffs, in addition to any increase in operating costs, would go far to offset the gains of independence. There are serious doubts whether some of the Intermediate Credit Banks with their present volume of business could carry their proportionate part of this additional expense. Much of their business is expensive to handle and, if costs of operation are increased, they will be less rather than more able to extend their services to the small producers whose cause the separationists are supposedly pleading. A change of attitude in respect to the necessity of cultivating new business wherever eligible loans are available can be achieved within the present set-up without sacrificing the economy of sharing costs with the Federal Land Banks.

It should be entirely feasible to make certain that three members²¹ of the Farm Loan Board are specially qualified to formulate policies for the Intermediate Credit

²⁰ *Annual Report of the Federal Farm Loan Board*, 1929, pp. 87-89.

²¹ At present the Board is composed of seven members including the Secretary of the Treasury as an *ex officio* member.

Banks. If three of the active members were selected because of their special fitness to administer long-term credits and three because of their familiarity with short-term agricultural credits, these two divisions could function separately as an Intermediate Credits Division and a Mortgage Credits Division of the Federal Farm Loan Board. A rotating chairman could be elected to preside at regular meetings of the full Board and to co-ordinate the work of the two divisions. A similar scheme could be worked to give the interests of the Intermediate Credit Bank a proper representation on the board of directors of each district. This formal division of functions would preserve the economies of the present arrangements, but would assure special attention to the short-term credit requirements of agriculture. Unless some solution can be devised which will result in a more constructive policy in extending the services of the Intermediate Credit Banks, the agitation for the separation of the two systems is likely to continue.²²

Another suggestion for securing a more stimulating atmosphere for the Intermediate Credit Banks is to transfer them to the Federal Farm Board.²³ Inasmuch as the future status and functions of the Board are in considerable doubt this suggestion is of little more than

²² Since this chapter went to press an executive order has been issued which will transfer all farm credit agencies of the federal government to the Farm Credit Administration. When this order goes into effect the Federal Farm Loan Board, with the exception of the Farm Loan Commissioner, will be abolished. See pp. 387-94 for a further discussion of this reorganization.

²³ Several bills have been introduced in Congress for the purpose of transferring the administration of the affairs of the Intermediate Credit Banks to the Farm Board. The Secretary of the Treasury made a report on H. R. 8563 and H. R. 9049 to the chairman of the House Committee on Banking and Currency in which he opposed any such transfer. See *Annual Report of the Federal Farm Loan Board, 1929*, pp. 89-90.

academic interest at the present time. Two aspects of the situation deserve careful study before any such transfer is seriously considered. The first concerns the effect of the transfer upon the credit status of the Intermediate Credit Bank debentures. Unless their credit remained intact the purpose of the transfer would be defeated at the outset. The second phase of the question has to do with the comparative advantage to the Farm Board of a parallel but wholly separate financial system which complements its services to agriculture, and an agricultural banking system which is under its direction. Although it is possible to do little more than speculate as to the effect of such a transfer upon the sale of debentures or upon the quality of services that would be available under the new set-up, a more intelligent judgment is possible after examining the role the Intermediate Credit Banks might be expected to play in any future program of the Farm Board.

CHAPTER XIV

THE INTERMEDIATE CREDIT BANKS AND THE FEDERAL FARM BOARD

The Agricultural Credits Act, under which the Intermediate Credit system was created, was passed six years before the Agricultural Marketing Act, which brought the Federal Farm Board into being. The former measure designated co-operative marketing associations as the sole recipients of loans secured by staple agricultural commodities but, apart from this provision, it showed no special solicitude for the co-operative movement. In respect to discounts, credit subsidiaries of co-operatives are only one of the several channels through which credit may be extended. The chief objectives of the Agricultural Credits Act were to make credit more available and to reduce interest rates to borrowers. The Agricultural Marketing Act was drawn very definitely in terms of co-operative marketing agencies, but makes no specific reference to financing operations which would utilize the facilities of the Intermediate Credit system. On the other hand, considerable stress was placed upon the Farm Board's use of its revolving fund to finance the operations of co-operative associations and, through them, of agricultural producers.

The three years of operating experience through which the Farm Board has now passed have given it an opportunity to evolve a fairly definite division of labor between the Farm Board and the Intermediate Credit system in which the former assumes the task of making loans not acceptable to commercial banking institutions or not eligible for the Intermediate Credit

Banks, and to some extent relieves the latter of any pressure to extend loans which do not measure up to conservative banking standards. Such a complementary development tends to simplify the task of the Intermediate Credit Banks in a manner impossible or at least difficult in the absence of a revolving fund administered by an independent commission charged with particular responsibilities toward the co-operative movement and the agricultural industry and having no obligation to private investors for the safety of their funds. We shall undertake to examine these several aspects of the Board's activities in the field of agricultural finance.

I. LOANS FROM THE FEDERAL FARM BOARD'S REVOLVING FUND

Under the heading "Loans to Co-operative Associations," Section 7(a) of the Agricultural Marketing Act authorizes the Board to make loans from its revolving fund to co-operative associations to assist in:

1. The effective merchandising of agricultural commodities and food products thereof;
2. The construction or acquisition by purchase or lease of physical marketing facilities for preparing, handling, storing, processing, or merchandising agricultural commodities or their food products;
3. The formation of clearing house associations;
4. Extending membership of the co-operative association applying for the loan by educating the producers of the commodity handled by the association in the advantages of co-operative marketing of that commodity; and
5. Enabling the co-operative association applying for the loan to advance to its members a greater share of the market price of the commodity delivered to the association than is practicable under other credit facilities.

We may group (3) and (4) as being in general promotional activities designed to enlarge and strengthen

co-operative organizations. The outlays for these purposes would in the first instance be financed by the Farm Board but on a loan basis. That is, the Board would expect to be reimbursed out of subsequent earnings of the associations, and the expense would be non-recurrent. No loans have been made under (3), and during the first three years only \$58,201 have been advanced for educational purposes. Promotional outlays of this sort are not of a commercial character; hence these particular uses of the revolving fund lie outside the field which could be served by commercial banks either with or without the use of the Intermediate Credit Banks.

Loans for effective merchandising of agricultural commodities and for the acquisition of permanent facilities have entailed the major use of the Farm Board's revolving fund outside of its stabilization operations. The former can be characterized in general as "working capital" loans. They are for the purpose of assisting new organizations to get into the swing of successful operation or to make up capital deficiencies of older organizations in order to keep their work from being interfered with or even terminated during the present or some later period of economic depression. Loans of this type are made on the unsecured notes of co-operatives supported by their financial statements. Business enterprises which can submit satisfactory financial statements ordinarily look to commercial banks for loans of this character, but unfortunately too many co-operatives have attempted to operate without sufficient capital investment, and commercial banks will not often finance them on their unsecured notes. Moreover the enormous number of bank failures in recent years has made it increasingly difficult for even well-established co-operatives to be financed adequately through commercial sources. Since the Intermediate

Credit Banks cannot loan directly to co-operatives for working capital purposes, the Farm Board is supplying them a loan service not available elsewhere.

Not only do co-operatives experience difficulty in obtaining working capital, but previous to the establishment of the Farm Board's revolving fund they had no source of long-term credit for the purchase or construction of permanent facilities. The facility loans of the Board are long-term loans made on an amortization basis, secured by first mortgages on the permanent equipment acquired by means of the advances. Although up to June 30, 1932 the Farm Board has advanced only 14.9 million dollars in facility loans, these advances are extremely important, for they enable co-operatives to acquire necessary equipment for more efficient operations and relieve them of dependence upon commercial facilities, which are often controlled by private interests antagonistic to the development of co-operative marketing.

The commodity loans provided for under (5) do not supply a deficiency in the credit facilities available for co-operatives, but merely supplement commodity loans of the Intermediate Credit Banks or similar loans from commercial banking institutions. These supplementary loans enable co-operatives to make more liberal advances to their members than is possible if they are wholly dependent upon commercial banks or the Intermediate Credit Banks. It is noticeable that the Marketing Act itself in this paragraph gives the Farm Board authority to extend credits in excess of those which regular banking agencies deem wise and safe. In its first annual report the Farm Board outlined its policy in respect to commodity loans as follows:

Loans made by the Board are supplemental to such credit facilities as are already available to the co-operative associations.

In the case of commodity loans to enable the association to make advances to its grower members on delivery of their products, the association first obtains a primary loan from a commercial bank or from one of the Federal Intermediate Credit Banks. Should it appear advisable that larger advances be made to the growers than the primary loan will permit, the Board may grant a supplemental commodity loan to the association. Such advances from the Board usually constitute only a relatively small proportion of the total amount borrowed on the commodity and are determined in each case by the supply, demand, and price situation pertaining to the commodity. In this way the revolving fund has made possible operations of a much greater extent than might appear from the amounts of money actually loaned to co-operative associations.

In short, supplementary commodity loans permit co-operatives to borrow a larger percentage of the market value of their commodities than prudent banking policy would approve.

One objection to supplementary loans as a permanent feature of the Farm Board's lending activities is their possible effect upon the development of co-operative marketing. Since farmers propose to control the distribution of their products co-operative associations must not be encouraged to borrow so heavily that their sales policies are likely to be dictated by their creditors. This principle is sound even if the creditor is a government board created specifically to promote co-operative marketing.

A more serious objection to supplementary advances from the point of view of the present discussion is their possible effect upon the functioning of the Intermediate Credit Banks. If these commodity loans of the Farm Board are made on a strict banking basis, they merely duplicate the services of the Intermediate Credit Banks. Consequently there appears to be no justification for them. If in a temporary emergency the Intermediate Credit Banks had difficulty in floating debentures, sup-

plementary loans from the Farm Board's revolving fund might supplement their advances to co-operatives; but ordinarily there seems no occasion for a second federal agency to furnish marketing credit to co-operatives. If it seems advisable in the case of particular commodities such as cotton or wheat to loan more than 75 per cent of the market value of the commodity pledged, it would be better to modify the Agricultural Credits Act to permit larger advances than to have another loan agency making supplementary advances.¹

The presence of the Farm Board as a second source of credit may encourage the Intermediate Credit Banks to restrict their loans to co-operatives more than they otherwise would do. If the Farm Board is willing to make the more hazardous commitments and to accept a secondary lien on the commodities as security, the Intermediate Credit Banks are able to finance the primary requirements of the co-operatives while allowing the Farm Board to assume the major risks of price declines. If this policy is followed co-operatives are justified in their complaints that the Intermediate Credit Banks are fair weather creditors just as are commercial banks. No satisfactory financial relationship between the Intermediate Credit Banks and co-operatives can be developed under such circumstances.²

¹ Comment on the possibilities of friction between the Intermediate Credit Banks as primary lenders and the Federal Farm Board as a junior lien holder on the same commodity is not pertinent to the present discussion. Suffice it to say that where the same commodity is pledged to a first and second mortgagee the junior lien holder may be forced in the case of price declines to take over the entire loan to protect his equity if the first mortgagee demands payment.

² It is impossible to determine the justice of the criticism that Intermediate Credit Banks have allowed the Farm Board to assume an unnecessary portion of the responsibility for financing co-operatives, but the marked decline in the volume of loans to co-operative marketing associations in 1932 affords some basis of fact for the complaints.

In carrying out its financial program with its loans for the purpose of facilitating marketing operations, advances to aid and extend co-operative organizations, and supplemental commodity loans, the Farm Board during its first year of operation loaned 101.8 million dollars. Of this amount 23 millions were repaid, leaving 78.8 millions outstanding on June 31, 1930. In the second year there were loans of 154.1 million dollars and repayments of 123.4 millions, leaving 109.5 millions outstanding. During the third year advances amounted to 101.1 million dollars, of which 40.5 millions have been repaid and 170.1 millions were outstanding on June 30, 1932.³ Of the total amount advanced up until June 30, 1932 only \$58,201 had been advanced for educational purposes, 181.4 millions for "effective merchandising," 14.9 millions for facility loans, and 160.8 millions for credits on commodities supplemental to those made by banking institutions.

It will thus be seen that the Farm Board has interpreted the mandate of Congress as meaning that it should employ its revolving fund to extend credits in fields involving more hazard than executives of banking institutions are willing to undertake. At the same time it is obvious that it has husbanded its funds in these fields in such a way as to insure as high a percentage of ultimate liquidation as possible, thus preserving the true character of the "revolving" fund rather than allowing it to degenerate into a one-way channel for the disbursement of relief funds.⁴ For example, of 443.8 million dol-

³ Loans to stabilization corporations which are authorized in Section 9 of the Agricultural Marketing Act are not included in these amounts.

⁴ This statement of course is not applicable to loans made to stabilization corporations, and to a considerable extent it is probably not true of supplementary loans. The amount of loss on supplementary loans

lars applied for the first two years, 57.4 millions were denied and 32.4 millions were withdrawn or pending on June 30, 1931. In the third year, of 121.1 million dollars applied for, 7.7 millions were denied and 9.6 millions were withdrawn or pending on June 30, 1932.⁵

In the preceding chapter we have called attention to the unwillingness of the Farm Loan Board or officials of the various Intermediate Credit Banks to have the system looked upon as in any sense an emergency agency or the proper channel through which "farm relief" funds could be distributed. Mention has also been made earlier of the dissatisfaction of various agricultural interests with the conservative loan policies of the Intermediate Credit Banks and the recurrent efforts to have their procedures liberalized, at least so far as this could be done by the repeal of the minimum margin requirements for loans to co-operative marketing associations.⁶

There can be no question that many of the proponents of the Agricultural Credits Act of 1923 hoped thereby to develop a system of cheap and easy credit. Those charged with the responsibility for administering the system, however, have been concerned in building up permanent and sound banking institutions. No doubt some of the interests that have felt disappointment in the actual operations of the Intermediate Credit system have turned their hopes now to the Farm Board as a source from which credit relief can be obtained in that twilight zone which the Intermediate Credit Banks re-

cannot be determined finally until the commodities are sold. A substantial recovery in commodity prices would reduce prospective losses.

A determined loss of \$789,380 is reported in loans for effective merchandising, which amounts to 1.5 per cent of the loans outstanding June 30, 1932.

⁵ These figures are from *Annual Reports of the Federal Farm Board*.

⁶ See Chap. X.

fuse to enter. Nevertheless the Farm Board too is disposed to proceed with caution in these more hazardous fields.

Various members of the Board have repeatedly called attention to the fact that it was not set up to dispense farm relief. Its function is to promote efficient types of co-operative associations for the distribution of agricultural products and so far as possible to stabilize the agricultural industry. It does not, however, seem a strained interpretation of the Marketing Act to take it to be the intention of Congress that the Board should administer its revolving fund with enough daring in times of emergency to give agriculture a liberal credit service even at the risk of some immediate impairment of the revolving fund.

But while the Farm Board has definitely accepted an aggressive role in this field, it has consistently sought to emphasize the long-run constructive purpose which it was seeking to promote by the use of its funds at points neglected by existing banking institutions. In its first annual report it disavowed any intention of becoming "a source of liberal advance of cheap money for the benefit of any and all organizations that might be able to meet the minimum requirements prescribed in the act." Instead, "the Board, believing such was the intention of Congress, has looked upon the use of the revolving fund as a means to the end of building up an efficient system of co-operative marketing associations." That is to say, it has insisted that applicants for credit meet their needs as fully as possible from regular lending agencies at going market rates. It reserves its own funds for application at such strategic points as would in its judgment best

¹ *Annual Report of the Federal Farm Board*, 1930, p. 4.

serve the purpose of building up a permanent farmer-owned and farmer-controlled system of marketing by supplying it with credit at times when and for purposes which commercial lending institutions are unable or unwilling to serve.⁸ To grasp the full meaning of its long-run policy we must proceed to the second division of our topic, which relates to the organization and operation of farmer-marketing agencies under the general support and guidance of the Federal Farm Board.

II. THE EFFECT OF CO-OPERATIVE DEVELOPMENTS UPON INTERMEDIATE CREDITS

The Agricultural Marketing Act of 1929 launched the Federal Farm Board on a vigorous campaign to expand and strengthen co-operative organizations in the United States. It is not the purpose of the present volume to discuss the methods employed, and it is much too early to express a judgment as to how great or how permanent the growth effected will prove to be. The Farm Board, however, is able to present statistics which indicate a very rapid expansion of the co-operative movement during the three years of its operation,⁹ and it is entirely reasonable to assume that, with more time and added experience on the part of the Board and less distressing general economic conditions, we might see a very great expansion of farmer-owned and farmer-controlled business agencies. In the light of our previous discussion of the relation of co-operative organizations to intermediate credit operations, it seems clear that this would tend to bring a substantial increase in the regular flow of busi-

⁸ We have already expressed doubt as to the wisdom of interpreting this to warrant supplementary loans in excess of the amounts that the Intermediate Credit Banks are equipped to advance.

⁹ See p. 240.

ness which would come to the doors of the Intermediate Credit Banks.

More important than this quantitative aspect of the matter, from the point of view of the Intermediate Credit system, is the possibility that the guidance of the Farm Board will result in improving and consolidating the operations of co-operative associations. Efforts are being made even in these formative years to put the affairs of the co-operatives on a higher plane of management and to strengthen their capital structures in order that extension of credit to them in the future may be easier and safer for whatever agencies may undertake it. While such progressive improvement in the business standing and methods of the co-operatives would to an extent make their business more acceptable to private lending agencies and cause it to flow in their direction to a greater or less degree, it seems clear that the Intermediate Credit Banks can, if they choose, make for themselves so definite a field of usefulness in agricultural financing that a substantial part of this expanded business would come into their hands.

Such an expectation seems distinctly to be strengthened by reason of certain trends which are manifesting themselves in the course of co-operative development under Farm Board auspices. We mentioned above the fact that the Farm Board was set up to establish an economical and efficient method of distributing farm products and, so far as possible, to stabilize the agricultural industry. More and more, as their work has progressed, it has become evident to members of the Board that the prompt and satisfactory fulfilment of either of these objectives calls for the building of an equally efficient and comprehensive system of agricultural fi-

nance. We have discussed in Part II the importance to co-operative associations of the direct loans for marketing purposes and the extent to which co-operatives and independent groups of farmers and business men have accommodated producers through credit corporations which rediscount with the Intermediate Credit Banks. But the real objective of the Farm Board is that the agricultural industry, permeated more and more with the idea and the actuality of group organization, shall have a system of financial agencies through which the needs of the industry may be met with the maximum liberality consistent with the nature of its security and the character of its business. It is hoped that this agricultural banking system shall cover all parts of the field of credit for agriculture not served on equally advantageous terms by other parts of our financial system.

Thus far the activities of the Farm Board in constructing such a banking system have not progressed very far. It has assisted in the organization of ten agricultural credit corporations affiliated with horticultural, grain, wool, and cotton co-operatives. By July 31, 1932 these credit corporations, through their affiliated co-operatives, had received \$3,035,700 of capital from the Farm Board. Of this amount \$1,420,800 was advanced to six cotton credit corporations; \$1,000,000 to the National Wool Credit Corporation, Boston; \$465,000 to the National Corn Credit Corporation, Chicago; \$100,000 to the Hastings Agricultural Credit Corporation, Hastings, Florida; and \$49,900 to the Coffee Growers' Credit Association, Ponce, Puerto Rico.¹⁰ This capital investment could support new crop production loans amount-

¹⁰ Some corporations have repaid small portions of the original amount advanced.

ing to 10 million dollars or more. In the livestock industry a more comprehensive plan has been set forth in the National Feeder and Finance Corporation, as discussed in Chapter VI. This development has thus far become operative at six points, but on July 31, 1932 the National Feeder and Finance Corporation and its six credit agencies had \$8,830,301 of loans outstanding.¹¹ These organizations could, under favorable circumstances, be developed into a very large and influential agency for financing the livestock industry as a whole. The real objective of such a development has been stated by C. B. Denman, the livestock member of the Farm Board, in the following words:

In the past, credit has been in inverse ratio with the requirements of the industry. Too often farmers have been unable to get sufficient credit when expansion in production was advisable. On the other hand, they have been literally intoxicated with credit at times, accentuating upward swings in production when conditions did not justify larger supplies. . . . The livestock and meat industry must be kept sound, and to be sound it must be soundly financed.¹²

Thus it appears that the Farm Board, in pursuing the double objective of "orderly production" and "orderly marketing" enjoined upon it in the enabling Act, has come to realize that the upbuilding of a sound and comprehensive system of agricultural finance must enter prominently into its major strategy. It has proceeded on the theory that the extension of credit by such private financing agencies as had grown up often ran to speculative excess which tended to throw agricultural production at various times and places out of balance with the

¹¹ These figures were obtained from the Federal Farm Board.

¹² *Co-operation Will Meet Problems of Livestock Industry*, Federal Farm Board Press Service, Mar. 25, 1932.

needs of the market. It believes that the shift from high-cost to low-cost areas of production or from less efficient to more efficient techniques is frequently hampered by local scarcity of capital or lack of understanding on the part of credit executives, and that through a similar shortage of credit or limitation forced by unwillingness to renew credit commitments plans for orderly marketing are disrupted and losses forced on the farmer class.

The Farm Board has established in principle and begun in practice a program for the creation of an efficient large-scale distribution department for agriculture. It hopes to buttress these marketing activities by sound leadership in helping to regularize and control production policies so that the producer will take full advantage of opportunities for supplying every market demand that can be met on a profitable basis and curtail production at those points where the ultimate result is financial loss. But if the producing and the distributing departments of the agricultural industry are to function smoothly and efficiently in any such system of economic planning, it is important that they be paralleled by an adequate, efficient, and harmonious system of agricultural finance concerned equally in removing credit disabilities from well-considered productive or distributive undertakings, and in withholding credit from those proposals which are so speculative or ill-considered as to promise individual loss or the disorganization of comprehensive plans for the orderly development of the industry.

The developments in the livestock industry already referred to show clearly how the Board may use its funds and its influence to forward the upbuilding of an adequate system of agricultural finance. Importuned to lend its funds direct to the livestock industry at low rates of in-

terest, the Farm Board pointed out that 500 million dollars was an utterly inadequate fund with which to attack the direct financing of agricultural distribution, that its purpose was to pyramid this fund by using it to stimulate and aid in the formation of agricultural credit corporations which would connect the largest possible body of producers with the open money market through the facilities already provided by the Intermediate Credit system.¹³ It therefore loaned funds to the National Livestock Marketing Association with the understanding that, through its subsidiary the National Feeder and Finance Corporation, the advances should be employed as a nucleus of capital with such producer groups as were themselves willing to put in an initial sum of their own and proceed to accumulate out of earnings the capital necessary to build up sound agricultural credit corporations. As such funds are repaid to the parent body, they can again be employed in establishing other credit corporations and, over a period of years, have a maximum influence in building up a comprehensive system of local credit corporations rediscounting with the Intermediate Credit Banks. The experience of the tremendously powerful British Co-operative Wholesale Society is an illustration of the surprisingly rapid rate at which a gigantic organization can grow from small beginnings. By devoting even a modest part of its revolving fund and consistently exerting its leadership in this direction the Farm Board could, in a period of 20 years, exercise an almost immeasurable influence in building up a system of producer-controlled financial institutions in the several branches of agriculture. It should be possible not only

¹³ See Edwin G. Nourse and Joseph G. Knapp, *The Co-operative Marketing of Livestock*, pp. 287-88.

to have these credit agencies conducted according to a high standard of internal efficiency but to have their activities effectively correlated with those of a comprehensive marketing system being constantly brought to a higher standard of sound business management through the educational efforts of the Farm Board and also effectively correlated with sound production programs in the various commodity fields.

Progress of the Farm Board along these lines is subject to definite limitations. Commercial banks and private loan agencies which may be entirely out of sympathy with the production policies of the Farm Board will continue to finance a large portion of our agricultural industry. Individuals not engaged in agricultural production may, if they choose, obtain loans from the 10 million dollar revolving fund of the Department of Agriculture to organize agricultural credit corporations to compete with those sponsored by the Farm Board. The regional agricultural credit corporations formed by the Reconstruction Finance Corporation are not obligated to conduct their operations with reference to the agricultural program of the Farm Board. Already the co-operatives through the Farm Board are objecting to the tendency to ignore co-operative associations in setting up these new credit facilities and express the fear that private banking interests may be in a position to negate their efforts to organize agriculture effectively.

Because of this duplication of credit agencies, the federal government finds itself in a somewhat anomalous position in its role of banker to agriculture. It advances funds to the Farm Board with which to finance producers who agree to adhere to a scheme of co-operative marketing. At the same time it sets up a loan fund which

enables farmers or business firms to organize credit corporations which give producers access to Intermediate Credit Bank funds without agreeing to market their products co-operatively. And, finally, as an emergency measure, it undertakes to set up credit corporations without waiting for private initiative to act and does not restrict their services to co-operative associations or their members. In short, the opportunity to influence production through the control of credit lies with the Intermediate Credit Banks, which discount acceptable paper for all eligible financing institutions, rather than with the co-operatives themselves.

The efforts of farmer-controlled co-operatives to enlarge their loan operations and to improve the business practices of their own credit affiliates should assure the Intermediate Credit Banks of a larger volume of well-selected loans provided co-operatives are not drawn into unsound projects in their haste to acquire an impressive volume of business. If the prestige of the Intermediate Credit Banks is enhanced thereby they are in a better position to insist upon conservative credit practices. Although the possibility of controlling production through the control of credit is probably grossly over-estimated, it would unquestionably have a salutary effect if loan policies were formulated in the light of prevailing market conditions and put into general practice by credit institutions which are interested in maintaining agriculture on a sound and profitable basis.¹⁴ It would appear that the Farm Board has a very important role in enabling the Intermediate Credit Banks to achieve this dominant position in the financing of all branches of our agri-

¹⁴ See Chap. XV for a more detailed discussion of the possibility of controlling production through the control of credit.

cultural industry. Finally, the Board can extend loans quite outside the scope of the Intermediate Credit Banks, and in emergency conditions it can somewhat simplify and limit their task by providing a certain fringe of marginal credit from its own revolving fund, whose administration is not circumscribed by as strict limitations as those properly imposed upon an agricultural banking system which draws its funds from the investment markets.

The Federal Farm Board and the Intermediate Credit Banks have quite distinct and separate functions and it would be a serious error to combine their activities under one administration. The promotional activities, the long-term facility loans, and the more hazardous supplementary commodity loans which at the moment are an accepted phase of the Farm Board's activities would have an adverse effect upon the credit status of Intermediate Credit Bank debentures. Close co-operation between the two institutions but complete separateness of their administration is the most satisfactory arrangement. The ability of the Intermediate Credit system to serve agriculture as a whole or even to promote a particular agricultural program is in direct proportion to its success in drawing upon short-term investment funds. Participation in any venture that jeopardizes this opportunity is ruled out by the very nature and purpose of the Intermediate Credit system.¹⁵

¹⁵ The Federal Farm Board, according to a recent executive order, is to be abolished. Such of its functions as are continued will be performed by the Farm Credit Administration, to which the supervision of the Federal Intermediate Credit Banks will also be entrusted. See pp. 387-94 for a brief discussion of the probable effects of this reorganization.

CHAPTER XV

THE PLACE OF THE INTERMEDIATE CREDIT BANKS IN OUR FINANCIAL STRUCTURE

Those who opposed the creation of the Federal Intermediate Credit Banks maintained that with more liberal access to Federal Reserve funds commercial banks could serve agriculture adequately without the necessity of creating a separate banking system. Since the passage of the Agricultural Credits Act this argument has lost much of its force in the face of hundreds of bank failures and the enormous shrinkage of deposit funds in agricultural areas. Although the desirability of a short-term rural credit system which relieves the independent country banks of the responsibility of financing agricultural producers is no longer seriously disputed, it remains to be seen whether Secretary Mellon was correct in forecasting that "necessarily this will be a secondary, and, in all probability, an inadequate rediscount system."¹

Whether the Intermediate Credit Banks are inadequate and fail to meet reasonable expectations depends largely on one's judgment as to the character of the loans they can afford to accept and the rapidity with which they can safely assume a greater responsibility for financing agriculture. An appraisal of their accomplishments to date, or an estimate of the place they may expect to achieve in our financial structure, must take cognizance of the conditions under which they operate and the character of the business allotted to them. We

¹ Letter of Secretary Mellon to Congressman McFadden, quoted in the *Commercial and Financial Chronicle*, Feb. 24, 1923, p. 771.

have already considered in Chapter XIII the difficulties of creating a discount system for agricultural paper and the various handicaps under which the Intermediate Credit Banks operate. We are now in a position (1) to determine which fields of activity offer possibilities of further expansion; (2) to examine the benefits which may accrue to agricultural producers, to their business organizations, and to the agricultural industry itself from a commercial banking system devoted exclusively to agricultural requirements; and finally (3) to judge whether the Intermediate Credit Banks are sufficiently well integrated into our credit structure to enable them to serve agriculture wisely and continuously. Their place in our financial system depends upon their ability to serve agriculture more intelligently and on better terms than other credit institutions can, and to do so on a basis sufficiently conservative not to interfere with their own ability to attract investment funds into agricultural enterprises.

I. FIELDS OF OPERATION CAPABLE OF FURTHER EXPANSION

Direct loans to co-operative marketing associations offer the largest single opportunity for expansion as well as the most lucrative field for the Intermediate Credit Banks to develop. The renewed interest in co-operative marketing since the Agricultural Marketing Act was passed has increased the number of associations eligible for loans and has enlarged the credit requirements of former customers. If the Intermediate Credit Banks compete actively for commodity loans they should have little difficulty in securing the major portion of this expanding business.² Since they are expected to finance

² See Chap. X.

co-operatives in poor seasons, when their business is less attractive to commercial banks, and to finance associations whose annual credit requirements are too small to attract metropolitan banks but often too large to be carried by local banks, they must also compete for loans at times when they represent profitable business.

A change of attitude on the part of co-operative marketing associations is also essential if the Intermediate Credit Banks are to render them the maximum service. Although co-operatives assume that the Intermediate Credit Banks will give special consideration to their peculiar requirements, they have been slow to recognize a reciprocal obligation to strengthen the Intermediate Credit system by utilizing its facilities whenever possible. Large-scale co-operatives, like other business organizations, require a dependable source of credit, but commercial banks decline to commit themselves to any permanent customer relationship.³ As co-operative marketing associations come to appreciate the need for banking services that are unaffected by local conditions or by the demands of more favored customers, the Intermediate Credit Banks can expect to finance regularly the greater part of their requirements.⁴

³ This point of view toward co-operative business was expressed by J. J. Sample of the Guaranty Trust Company of New York, and Wilbert Ward of the National City Bank, New York, and is confirmed by the experience of co-operatives in securing lines of credit from commercial banks.

⁴ A permanent upward trend in direct commodity loans is of course closely linked with the success of the Federal Farm Board in reorganizing agriculture on a co-operative basis, but at the moment there is no reason to assume that co-operative marketing will decline, at least not in the major staples, which account for most of the direct loans. Loans to co-operative marketing associations for 1931 increased nearly 25 per cent over the preceding year, even in the face of extraordinary price declines for all commodities, but in 1932 they showed a precipitous drop. See the table on p. 239.

The financing of livestock operations is another promising field for further expansion. The 3 per cent margin which is now authorized permits livestock credit corporations to compete successfully for business with commercial lending agencies. If this spread is not sufficient to cover operating costs the credit corporation may charge a fee to cover actual inspection costs. Even the lack of capital for livestock credit corporations is no longer a serious obstacle to the expansion of loans. During its first three years of existence, the Federal Farm Board was directly responsible for bringing 2.3 million dollars into the livestock loan business, while the regional credit corporations organized by the Reconstruction Finance Corporation are expected to find their greatest opportunity for service in the livestock areas.⁵

Any substantial growth in crop production loans is quite unlikely so long as attention is focused upon the reduction of interest rates below the level warranted by the character of the loans. A gross margin of 3 per cent, even if the credit corporation is permitted to recover from borrowers the direct costs incurred in placing their loans, is seldom sufficient to cover other operating costs and absorb unavoidable losses. Under a few exceptionally favorable circumstances a moderate expansion of crop production loans is feasible. As co-operative marketing associations enlarge their purchasing activities they may choose to use the profits from the sale of supplies to subsidize a credit corporation to finance the production

⁵ Livestock producers can obtain loans for the purchase of stock in livestock loan companies from the 10 million dollar revolving fund administered by the Department of Agriculture but, with the Federal Farm Board and the Reconstruction Finance Corporation both undertaking to furnish local credit facilities for livestock producers, there is less occasion for individual producers to borrow funds for the same purpose.

requirements of their members. In this way they can gradually take over the financing of a larger proportion of their more efficient members who otherwise would be dependent upon trade credit.

Co-operative associations or commission firms marketing specialty crops such as citrus fruits, potatoes, apples, and mixed vegetables can finance their members advantageously and with less chance of loss than can co-operatives marketing staple crops. A majority of the former sell supplies, and thus have a close control over the expenditure of loan proceeds as well as ample trading profits. These profits, together with retains on produce sold, enable them to absorb any losses which may occur. Since specialty crops must be sold through established channels, affiliated credit corporations can avoid the expense of direct collections. With the elimination of losses arising from the misuse of funds and from the failure to collect, these credit subsidiaries have a fair opportunity to finance a majority of their members or customers at a reasonable cost.

But even if co-operatives and business interests are willing to underwrite production loans, the Intermediate Credit Banks will not discount crop loans freely unless there is a reasonable expectation that all loans can be liquidated out of current proceeds. One disastrous season can easily wipe out the entire capital of the average agricultural credit corporation, thus making its future indorsement quite valueless. Consequently if loans on growing crops are to be financed safely they must be extended only on the basis of an intelligent use of reliable data concerning production costs, crop yields, and prospective prices. If well-financed agricultural credit corporations undertake to make production loans only af-

ter a careful study of these data, their paper should meet all reasonable criteria of safety and be quite acceptable to the Intermediate Credit Banks. Merely to state the condition under which crop production loans can be discounted freely is to deny the possibility of any large increase in this type of business.

Producers who pledge their equities in warehoused commodities as security for loans have little prospect of drawing heavily on the Intermediate Credit Banks. Since equity loans are usually secured by the same commodity which a co-operative association has pledged as collateral for direct loans, they are regarded as extra hazardous and therefore undesirable business.⁶ In theory individual farmers can store their grain or cotton on the farm and, if acceptable warehouse receipts are tendered, borrow on their personal notes with these receipts as collateral. Most farmers market their crops at harvest time, however, and so there is unlikely to be a large demand for loans of this type.⁷

Pre-shearing advances will undoubtedly expand as

⁶ It has already been noted that the Intermediate Credit Banks carry very little of this paper at the present time. See p. 269.

⁷ Since farmers do not ordinarily withhold their crops from the market except in cases of severe seasonal price decline, the Intermediate Credit Banks would hesitate to finance any quantity of such paper even if it were well margined and indorsed by a financially responsible credit corporation unless they believed the low prices to be very temporary and unwarranted in the light of general market conditions. Although the National Agricultural Credit Corporations of Des Moines and Fort Dodge, Iowa were organized in the fall of 1925 to enable farmers to withhold their corn from the market until prices recovered, the recent experience with declining prices for agricultural commodities makes banking institutions unwilling to finance the carry-over of commodities in the expectation of improved prices. Moreover the provisions of the state law and the supervision of warehousing facilities would determine whether such loans could be made safely. Consequently the privilege of borrowing on commodities stored on the farm is limited to a few states.

co-operative wool associations market a larger portion of the total clip. These loans, which furnish wool growers working capital in advance of spring shearing, provide wool co-operatives with an effective competitive device in the securing of deliveries which they are quite willing to use. Furthermore the character of the security and the moderate amount which is advanced per fleece furnish the Intermediate Credit Banks adequate protection against loss.

Whether discounts for credit affiliates of co-operative purchasing associations can be materially increased is less easily predicted. The Farm Loan Board is reluctant to rule that loans for the purpose of furnishing working capital for these associations are for an agricultural purpose within the meaning of the Agricultural Credits Act, and apparently it hopes to discourage any substantial development of this type of business. Thus far only two co-operative associations have borrowed from the Intermediate Credit Banks, and any further development in this field of activity must await a more sympathetic attitude on the part of the Farm Loan Board, or possibly a more aggressive action on the part of co-operative buying associations in obtaining a modification of the Agricultural Credits Act which will declare the paper of co-operative buying associations eligible for discount.⁸

After exploring the fields in which the Intermediate Credit Banks have the greatest opportunities for expansion, it is clear that under the present circumstances co-operative marketing associations which borrow on the security of warehouse receipts or shipping documents, and livestock producers (including wool growers) are

⁸ See Chap. XI for a discussion of equity loans and pre-shearing advances.

the only groups that can look to the Intermediate Credit system for a substantially larger portion of their credit requirements. Successful exploitation of these fields assumes of course that the Intermediate Credit Banks are disposed to compete with commercial credit institutions for loans. But in attempting to appraise their ultimate place in our financial structure it is permissible to assume that they will endeavor to take over all loans which they can finance with safety to themselves and with advantage to their customers. If they do follow a more aggressive policy, what benefits may we expect will accrue to individual producers, to their business organizations, and to the agricultural industry as a whole?

II. ADVANTAGES OF AN INTERMEDIATE CREDIT SYSTEM FOR AGRICULTURE

Livestock and agricultural producers are immediately concerned with securing through the Intermediate Credit system two advantages not offered them by commercial banks of deposit. They expect (1) lower interest rates than commercial banks allow and (2) ample credit whenever they have good reason to believe they can use borrowed funds profitably.

Whether the Intermediate Credit Banks have succeeded in reducing the general level of interest rates for agriculture is extremely doubtful. Pressure upon the prevailing level of rates presupposes that the Intermediate Credit Banks compete with commercial banks for business, and we have already seen that they have done so only to a very limited extent. Some competition occurs, but as yet most of the loans discounted by the Intermediate Credit Banks have been relinquished gladly to agricultural credit corporations or livestock loan companies because the business was no longer profitable or

because commercial banks were replacing agricultural loans with commercial loans or by loans on stock market securities and investments.*

The competition of the Intermediate Credit Banks apparently has reduced interest rates for producers in the more isolated livestock areas. These lower rates are offset in part by inspection charges and payments for other expenses to enable livestock credit corporations to compete successfully with commercial loan companies; and during prolonged periods of easy money it is quite likely that commercial lenders offer more favorable rates to livestock producers who can qualify for loans with the Intermediate Credit Banks.

Individual farmers have benefited by lower interest rates for crop advances even if the general level of rates has been unaffected by the competition of the Intermediate Credit Banks. If borrowers are required to supply the capital for the credit corporation and to reimburse it for the actual costs of placing their loans, crop production credit may cost them 15 or 25 per cent. Such rates represent substantial savings over the charges for time purchases because the Intermediate Credit Banks insist that borrowers must be quoted the lowest prevailing cash price for fertilizer and supplies. Furthermore, if crop production loans are obtained through credit subsidiaries of co-operative marketing associations which share the operating costs of the credit corporations, members who can qualify for loans secure their supplies at cash prices without paying the entire cost of the loan service which made cash purchases possible.

Thus far the number of livestock and agricultural producers served is too small to warrant the conclusion that

* See p. 313.

local rate structures or interest costs have been modified materially over any considerable area. A study of the loans outstanding August 30, 1930 in the Omaha District shows that 2,419 livestock producers received advances amounting to slightly more than 6 million dollars. The average size of loans in this district is distinctly smaller than in the Houston and Berkeley Districts, but if we accept these loans as representative not more than 20,000 livestock producers were financed by the Intermediate Credit Banks in 1930.

The organization of regional credit corporations affiliated with the National Livestock Marketing Association in each livestock district will increase the number of producers accommodated, and will undoubtedly exert further pressure upon interest rates in these areas. Since these credit affiliates share overhead costs with the livestock marketing associations they may be able to operate on less than a 3 per cent margin after they develop a large volume of loans. Even if they do retain the entire margin, their competition will exert pressure upon interest rates in the more remote sections of the livestock areas whenever discount rates fall below 5 per cent.¹⁰

¹⁰The National Feeder and Finance Corporation has announced that it will charge a uniform interest rate of 6 per cent throughout the territory it serves. Since its operations covered 26 states in 1931 and its six regional credit corporations had \$8,830,301 of loans outstanding July 31, 1932, this policy of loaning at rates below the prevailing level will tend to reduce interest rates unless the effect is to draw off the high-grade loans and leave to commercial lending agencies only the second-rate credit risks which cannot qualify for Intermediate Credit Bank loans. In this case rates on the less desirable loans might be increased instead of reduced. Such a division of business between the Intermediate Credit Banks and commercial agencies is less probable than that the latter will meet the competition on the most desirable loans but maintain their rates for customers who cannot qualify for Intermediate Credit Bank loans. See C. A. Stewart, "Financing Livestock

The number receiving crop production loans is somewhat larger than that for livestock loans, but even so it is extremely small. The table on page 219 shows that 3,716 borrowers, chiefly from the Columbia District, were advanced \$5,115,300. Loans to Texas cotton farmers, Louisiana sugar-cane planters, and Mississippi staple cotton growers are larger than the average in this table; but, if these loans are accepted as typical, not more than 22,000 farmers received crop production loans from the Intermediate Credit Banks in 1930. So long as the benefits of lower rates are confined to a small number of highly selected credit risks, discount rates of the Intermediate Credit Banks can have no appreciable effect upon commercial interest rates.

Accessibility of credit is as important to the borrowers as lower interest rates, but Intermediate Credit Bank funds are not always readily available to eligible applicants. Now that the National Livestock Marketing Association has set up a number of livestock loan companies, producers with acceptable collateral who are willing to market their finished animals co-operatively can obtain credit readily.¹¹ Commercial banks and cattle loan companies continue to finance livestock operations and,

Feeder Operations," and P. O. Wilson, "Problems of a National Livestock Marketing Association," *American Co-operation*, 1931, Vol. II, for a discussion of policies of the National Feeder and Finance Corporation.

The figures for loans outstanding July 31, 1932 were obtained from the Federal Farm Board.

¹¹ The National Feeder and Finance Corporation, with its local units, loan primarily on feeder stock. Loans on cows or ewes are restricted to the amount of the estimated proceeds of sales from the increase of the herd or flock. Although these loans are actually breeding loans, they are designated as marketing advances. They are not rediscounted with the Intermediate Credit Banks but are carried by the National Feeder and Finance Corporation. See Stewart, "Financing Livestock Feeder Operations," *American Co-operation*, 1931, Vol. II, pp. 129-34.

if the Intermediate Credit Banks undertake to educate these financing institutions to the advantages of using their discount privileges more liberally, livestock producers with adequate security and a reasonable equity in their business should find it easier to secure loans from them.

Small farmers whose security consists of a crop mortgage and miscellaneous farm equipment do not have easy access to the open money markets through the Intermediate Credit Banks nor are they entitled to it. The only time that crop production loans can be discounted safely in any quantity is when the indorsements of the financing institutions which originate loans guarantee their prompt redemption at maturity. But such indorsements do not always insure that the loans will be taken up at maturity, because often the capital resources of the indorsers are limited and their earnings on rediscounted paper restricted. As a result the majority of farmers find that production credit is no more accessible than it was before the Intermediate Credit Banks were established. Changes in banking mechanism alone will not make it possible for the small farmer or livestock producer, with his unstandardized collateral and uncertain returns, to borrow freely in the open money markets.

The regional agricultural credit corporations recently established by the Reconstruction Finance Corporation may offer a solution to the problem of making Intermediate Credit Bank funds more accessible if they are retained as a permanent part of our financial structure. These corporations are authorized to rediscount paper with the Reconstruction Finance Corporation, the Federal Reserve Banks, and the Intermediate Credit Banks. Thus far, however, they have depended entirely upon

their own resources and borrowings from the Reconstruction Finance Corporation. If the regional corporations are made permanent credit institutions, the Intermediate Credit Banks will become the natural outlet for their paper, since the Reconstruction Finance Corporation is presumably a temporary organization. The Reserve Banks are unlikely to discount any considerable volume of paper for these corporations because criticism is certain to arise if Reserve Bank funds are placed freely at the disposal of non-member institutions which neither maintain deposits with them nor contribute to their capital stock.

Inasmuch as regional agricultural credit corporations serve all agricultural producers without reference to membership in any co-operative association, their field of usefulness is wider than that of the credit corporations sponsored by the Federal Farm Board. Their minimum capital of 3 million dollars, furnished by the federal government, affords them resources far in excess of credit corporations established by private initiative. Furthermore, Congress made no stipulations in respect to interest rates to customers except that they should be "fair and equitable," which presumably leaves the credit corporations free to adjust rates in accordance with their costs of doing business. Of course if they undertake to finance a large volume of more hazardous loans and to make charges commensurate with the risks assumed, rates will undoubtedly be so high as to make the loans ineligible for discount with the Intermediate Credit Banks unless a wider spread above the discount rate is authorized.¹²

¹² The announcement that loans obtained through the regional agricultural credit corporations would carry an interest rate of 7 per cent provoked considerable adverse comment from agricultural leaders. A lower rate, however, would have had the effect of attracting business

Although additional well-financed discount corporations to connect producers with Intermediate Credit Bank funds are indispensable if the system is to be utilized effectively, it is imperative in the best interests of producers as well as of economy in operation that unnecessary duplication of facilities be discouraged.¹³ Otherwise the multiplication of institutions will result in maintaining high rates rather than in insuring borrowers more direct access to cheaper money. But the creation of additional local machinery is not in itself a guaranty that funds will be made available to agricultural producers.

Before funds can be readily drawn into agricultural industries from the short-term investment market, agricultural operations must be placed on a profitable basis. The Intermediate Credit Banks may contribute to the readjustment of agricultural activities upon a sound economic basis in two ways. In the first place they may finance farmers' co-operative marketing and purchasing associations which are attempting to reduce costs and to enlarge the returns which go to agricultural producers. And, second, their loan policies may tend to discourage a too rapid increase of production under the stimulus of rising prices; or to limit the flow of funds into agricultural enterprises whenever market conditions indicate that a curtailment of credit is desirable.

If co-operative marketing associations are to replace, or to compete effectively with, commercial distributors, they require a dependable and ample source of marketing credit at favorable rates. Thus far adequate credit

from established credit corporations rediscounting with the Intermediate Credit Banks.

¹³ For a further discussion of this point see "Reorganizing Our Agricultural Credit Facilities," a paper read by one of the authors at the 23d annual meeting of the American Farm Economics Association, Cincinnati, O., Dec. 30, 1932.

for their marketing programs at low rates has been forthcoming, although not always with the prodigality that a few associations urge. Other associations admit that in emergencies the Intermediate Credit Banks have supported their programs of orderly marketing well beyond the limits dictated by conservative banking practice.¹⁴

Co-operatives also use Intermediate Credit Bank funds to finance the production of commodities. In some instances co-operative marketing is impossible without these production loans. Fruit and vegetable co-operatives cannot compete successfully with private commission firms without advancing production credit because growers assign their prospective crops in return for loans. In the beginning co-operatives had difficulty borrowing from commercial banks to finance their members' production programs, but now that the Intermediate Credit Banks furnish them a dependable outlet for members' notes they can compete more effectively with commercial distributors who have easier access to commercial banking facilities.¹⁵

Production loans to growers of staple crops are less effective in building up co-operative marketing associations. Too often the co-operative finds itself financing a large number of semi-solvent members whose deliveries represent a small portion of its total business. And what is more serious, these loans do not always insure deliveries. If the first advance after delivery is not sufficient to pay off their production loans and allow them

¹⁴ See R. H. Montgomery, *Co-operative Pattern in Cotton*, p. 180.

¹⁵ It should be kept in mind that the Intermediate Credit Banks do not give co-operatives any special privileges in respect to production loans for their members since commercial distributors can rediscount eligible paper for their customers through agricultural credit corporations which they control.

some money for current expenses, members may sell a portion of their crops outside the association. If the association brings pressure to bear upon these members to secure complete deliveries, the effect is to arouse resentment rather than to enhance the prestige of the association.

Loans to livestock producers probably insure some deliveries that otherwise would be lost to co-operatives, for private commission houses finance shippers and co-operatives must offer a similar service if they expect to secure patronage. Such financial assistance may be essential in many cases, but loyalty to co-operative marketing must in the last analysis be based upon a clear demonstration that a producer-owned and controlled system of distribution serves producers and the industry more satisfactorily than do commercial distributors. Nevertheless co-operatives require time to demonstrate their ability to serve producers effectively, and in the meantime the Intermediate Credit Banks enable them to finance their members and to compete on more equal terms with private firms having lines of commercial credit.

To accelerate the transfer of marketing functions from commercial enterprises to co-operatives is of small benefit to agricultural producers unless the change results in larger net returns from current operations. The economies which can be realized through the co-operative marketing of agricultural products are less conspicuous than co-operative leaders had hoped. Further economies are gained through the co-operative purchasing of supplies, which is facilitated somewhat by production loans which enable farmers to pay cash for their purchases. But more profitable operations in most instances call for a decrease in production as well as lower unit costs and improved

marketing facilities. Can the Intermediate Credit Banks, through their control over credit, aid in re-establishing agriculture on a more profitable basis by refusing accommodation to high-cost producers or by forcing the withdrawal of marginal land from production?

Any influence which the Intermediate Credit Banks may have in adjusting production in accordance with market demands is as yet potential. At present they finance too small a portion of our agricultural or livestock industries to affect output through the control of credit. If their volume of business increases and they succeed in standardizing credit practices throughout a substantial part of any branch of agriculture, their loan policies may exert a stabilizing influence upon production programs.

Thus far the livestock industry affords the best instance of attempts to influence production through credit policies. The Intermediate Credit Banks recognize the dangers of supporting a rapidly rising market with too generous advances of credit and increase their loan margins if market conditions are such as to encourage livestock producers to expand their operations rapidly in anticipation of still further price advances.¹⁶ By reduc-

¹⁶ In 1928 September steers were selling at 13 cents and feeders wished to borrow the full purchase price, but the Intermediate Credit Bank of Omaha established a maximum loan limit of 10 cents. The president is convinced that the bank lost some customers because of this conservative policy, but the producers who were accommodated on these terms were not obliged to sell their livestock because the margins on their loans could not be maintained.

The management of the National Feeder and Finance Corporation also is opposed to the rapid expansion of credit in times of rising prices. C. A. Stewart, manager, says: "Our policy, which we believe we can make effective in a general way, is not to follow a general upward trend in livestock marketing unless the same margin of security and collateral can always be maintained. It is our policy not to be a contributing factor toward increased production by financing breeding op-

ing the amount that can be borrowed they discourage a rapid increase of loans at a time when excessive optimism leads operators to expand production on too small an equity. When the boom period culminates, producers whose loans were well margined in the first place are not forced to liquidate their holdings on a falling market and contribute further to the demoralization of prices. Since depositors' claims do not affect Intermediate Credit Bank resources, notes can be renewed as long as the underlying security affords them adequate protection.

Because of this policy of requiring substantial margins at all times, speculators and inexperienced operators find it more difficult to enter the industry on easy credit. Hence another disturbing factor during boom periods is subject to some control. Regular producers expect to increase their operations when prices are rising. To finance in addition speculators attracted into the business temporarily is likely to result in a further unbalancing of production and to accentuate the fluctuations in prices that periodically disorganize the livestock industry.¹⁷

In financing crop production loans the Intermediate Credit Banks tend to restrict advances to amounts that can be repaid even in bad seasons, which places less efficient producers at some disadvantage and presumably makes it more difficult to keep inferior land in cultivation. As a practical matter, however, the loan policies of

erations, especially beyond a certain point. It will be our policy to restrict credit." *American Co-operation*, 1931, Vol. II, p. 133.

¹⁷Objections are frequently made that this policy of wide margins makes it extremely difficult for farmers in the grain areas to diversify their farming operations by raising a little livestock or keeping a few dairy cows. But if producers lack both experience and sufficient capital to provide the necessary margin, the Intermediate Credit Banks cannot afford to finance the transaction on a 1 per cent spread.

most credit corporations have little or no effect upon the production of staple crops because they affect a negligible number of producers.¹⁸ In fact there is some justice in the charge that the Intermediate Credit Banks have accentuated the evils of over-production by financing producers through agricultural credit corporations controlled by processors and brokers who are interested in low prices for raw materials rather than in profitable returns to growers. Although data are lacking either to prove or to disprove this assertion, Intermediate Credit Bank officials who are in a position to judge admit that it may be true.¹⁹

A general effort to establish more scientific loan bases for production credits would have a salutary effect, since advances could be adjusted to a conservative estimate of current returns. But only through the concerted action of all those financing production and a common desire to

¹⁸ Whenever the Federal Farm Board makes loans to co-operative associations for the purpose of strengthening the credit corporation they control, there is a disposition on the part of the local management to enforce more conservative loan policies by attributing them to regulations imposed by the Federal Farm Board. After the Staple Cotton Cooperative Association had obtained a loan of 1 million dollars to increase the capital of the Staple Cotton Discount Corporation, it announced that loans would be made only if growers would agree to plant not more than 65 per cent of their cultivated land in cotton in 1931 and also to plant a reasonable acreage in feedstuffs. Since the Staple Cotton Discount Corporation advances from 5 to 7 million dollars annually for production purposes, it has some opportunity to influence production by such regulations. See *Staple Cotton Review*, January 1931.

¹⁹ Mr. R. T. Evans, vice-president of the Federal Intermediate Credit Bank of Berkeley, in answer to the question as to whether loans to processors and brokers did not invite a marginal acreage into production and cause over-production, replied: "Credit banks while making available funds at such reasonable terms contribute to the expansion of production along certain lines beyond what is good for the growers generally. . . . If these banks are used extensively in connection with production loans they may carry a heavy responsibility as far as the matter of surplus is concerned." *American Co-operation*, 1928, Vol. I, pp. 447-48.

restrict credit to those who can use it profitably at the prevailing level of prices would these policies have any effect in reducing production in line with consumption demands. The Intermediate Credit Banks alone, no matter how wisely they are administered, can do very little to curtail production.

Although only modest claims may be advanced for the accomplishments of the Intermediate Credit system thus far, its possibilities for future development and for placing the financing of agricultural production and marketing on a more secure basis are excellent if its opportunities are not jeopardized by too rapid expansion in hazardous fields before the banks have accumulated ample reserves for losses and before the credit corporations which originate loans are allowed to collect sufficient revenue to absorb their own losses. Otherwise the loan services of the Intermediate Credit Banks will be restricted because their own sources of credit are impaired.

III. THE INTEGRATION OF THE INTERMEDIATE CREDIT BANKS INTO THE CREDIT STRUCTURE

The ability of the Intermediate Credit Banks to draw funds from the investment market into agricultural industries has not been seriously tested, but there is every reason to believe that they can now meet any prospective demands for accommodation. If short-term investment funds disappear or are available only at excessive rates, the Intermediate Credit Banks are sufficiently well integrated into the Reserve system to prevent the first impact of a credit stringency from falling with full force upon agriculture. If in time of tightening credit the Reserve system follows its customary practice of keeping acceptance rates low in order to facilitate business, agriculture should benefit because the Intermediate Credit

Banks are now authorized to create acceptances, and acceptances have a ready market with the Reserve Banks.²⁰ Their debentures have been made eligible for member bank 15-day borrowings; and they may rediscount agricultural paper with the Reserve Banks or look to them as purchasers of debentures. So long as they maintain a high credit standing and a reputation for conservative management, producers and co-operatives whose collateral entitles them to the favorable credit terms offered by the open money market will receive credit on terms comparable with those offered to commerce and industry through our commercial banking system.

But it must be remembered that the Intermediate Credit Banks are an agricultural banking system and not relief agencies for agriculture. If they are to have the privileges accorded to commercial banks in the acceptance and short-term investment markets and at the Reserve Banks, they must be administered in accordance with sound banking principles and they must be appraised and criticized by banking standards. Much of the criticism leveled at the loan policies of the Intermediate Credit Banks and many of the complaints as to their seeming indifference to a more pretentious scale of operations fail to concede this point. Congress has recently removed several of the restrictions under which the system operated, but no legislative enactments can reduce the risks that are inherent in the financing of agriculture.

The narrow margins on which the Intermediate Credit Banks and local discount corporations operate force them to restrict their services to producers and co-operatives

²⁰ Considerable doubt is expressed by administrative officers as to whether the Intermediate Credit Banks will find acceptance credits well adapted to their purpose. As yet no use has been made of the privilege of creating acceptances.

whose collateral is ample and whose operations promise to be profitable. Before they are urged to take over a large volume of more hazardous loans they must be allowed more discretion in adjusting interest rates in accordance with the risks they assume. Arbitrary interest margins are as ineffective in protecting borrowers as are usury laws, and their effect is to force the Intermediate Credit Banks to leave much of the field of agricultural credits to commercial lenders who are not only free from legislative restrictions upon their charges but often outside the supervision of any authority in a position to protect borrowers from exorbitant rates. An enlargement of the discretionary authority of those charged with the administration of the Intermediate Credit system, and the removal of the legal restrictions upon interest rates, are the first steps toward a healthy expansion of its loans.

But, if the Intermediate Credit Banks expect to maintain their character of permanent banking institutions, they must not participate directly in promotional schemes for the reorganization of agricultural production or distribution, no matter how urgent the need. To be sure, a national program looking to the readjustment of agricultural production in accordance with existing market demands cannot hope for success except as it is supported by a rural credit system interested in the same objectives, but the latter must be entirely free to participate in this program only so far as it can do so without endangering its own credit. By co-operating with the Federal Farm Board and with other agricultural organizations along these lines, the Intermediate Credit Banks may be able to promote more stable farm production and more orderly marketing.

The conclusions to which the foregoing analysis of the

development of the Federal Intermediate Credit system leads us can be briefly summarized.

1. Agriculture requires a more dependable source of short-term credit than is furnished by our commercial banks of deposit.

2. The development of adequate local institutions to connect producers with Intermediate Credit Banks cannot be left solely to individual enterprise. If the regional agricultural credit corporations established by the federal government as emergency credit agencies can be retained as permanent facilities, they will afford additional contacts with Intermediate Credit Bank funds. The organization of additional credit corporations by private groups should be brought more closely under the supervision of the Intermediate Credit Banks.

3. Co-operative marketing associations have in the Intermediate Credit Banks permanent banking connections which assure them access to ample credit for marketing purposes at favorable rates. Moreover, the loan services of the Intermediate Credit Banks compare favorably with those offered to co-operatives by commercial banks.

4. The effort to maintain uniformly low interest rates upon all types of agricultural and livestock paper must be abandoned if the Intermediate Credit system is to be developed to its maximum usefulness.

5. Opportunities are present for the further expansion of the loan services of the Intermediate Credit Banks but such a program of expansion must proceed slowly and await the strengthening of the financing institutions which offer paper for discount or seek to borrow on their notes payable. An increase in loans to co-operative marketing associations will follow the further growth of the

co-operative movement and the improved credit status of existing associations.

6. The Federal Intermediate Credit Banks will be able to furnish agriculture with a dependable source of credit at a cost commensurate with the risk and expense involved only so long as their administration commands the confidence of the investing public and of the Federal Reserve Banks. This condition restricts their activities to loans which meet sound banking standards and prevents their participation in promotional or relief programs in the rehabilitation of our agricultural industries.

ADDENDUM

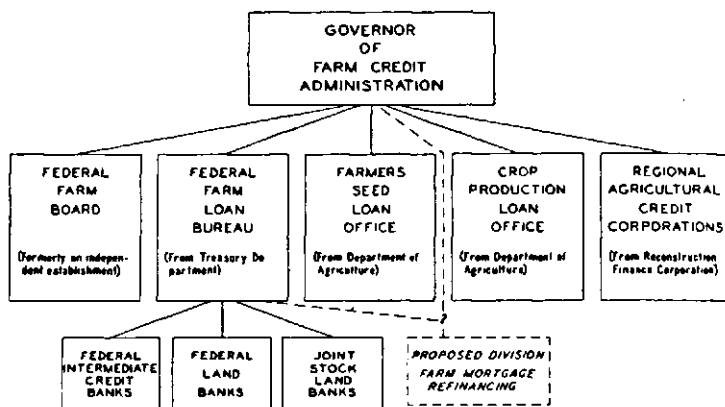
THE FARM CREDIT ADMINISTRATION

An executive order of March 27, issued after the preceding chapters had gone to press, authorizes the consolidation of all agricultural credit functions of the federal government under one authority. This order, which will become effective May 27, 1933, transfers the Federal Intermediate Credit Banks, the Federal Land Banks, and the Joint Stock Land Banks,¹ as well as the divisions of the Department of Agriculture and of the Reconstruction Finance Corporation which have to do with agricultural credits, to a new agency—the Farm Credit Administration. The present chairman of the Federal Farm Board will become governor of the Farm Credit Administration and will be directly responsible to the President. The accompanying chart indicates the divisions which have been transferred to the Farm Credit Administration and the several departments from which

¹ Although the Joint Stock Land Banks are privately owned they are supervised by the Federal Farm Loan Bureau.

they came. It also shows a proposed division which may be added if pending legislation is enacted.

CO-ORDINATION OF FARM CREDIT AGENCIES



The types of loan services which will be consolidated under the Farm Credit Administration include: (1) Long-term mortgage loans of the Federal Land Banks and the Joint Stock Land Banks; (2) short-term credit for the production requirements of individual producers; (3) short-term credit to farmers' co-operative associations to enable them to market their products more effectively; and (4) long-term credit to co-operative associations to assist them in obtaining adequate permanent equipment. A fifth type of service will be made available to farm mortgagors if the legislation now pending before Congress providing for the refinancing of farm mortgage indebtedness is enacted.

A number of changes in administrative personnel will accompany this re-alignment of credit facilities. The Federal Farm Board, except for its chairman, who will be governor of the new organization, is to be abolished. A

Co-operative Loan Commissioner has been appointed to supervise the functions formerly handled by the Farm Board. The Federal Farm Loan Board is also to be abolished. Its chief administrative officer, the Farm Loan Commissioner, will be retained to administer the Federal Land Banks, the Joint Stock Land Banks, and the Federal Intermediate Credit Banks. The appointment of a third commissioner has been announced; he will handle the emergency loan functions of the Reconstruction Finance Corporation and the Crop Production Loan Office of the Department of Agriculture.² It is possible that a fourth commissioner will be appointed to administer the refinancing of farm mortgages if the bill for refinancing farm mortgage indebtedness is passed. However, it seems more probable that this task will be entrusted to the Farm Loan Commissioner.

The merging of all agricultural credit agencies of the federal government into a single establishment may have several important results for the Intermediate Credit Bank system, at least two of which are entitled to brief comment. In the first place, it will simplify the problem of separating the administration of the Intermediate Credit Banks from that of the farm mortgage banks. This separation has been repeatedly urged and could now be accomplished as a matter of mere intra-departmental organization. The tentative plan apparently does not contemplate such a separation. However, unless an intelligent and vigorous development of the Intermediate Credit Bank facilities takes place under the proposed plan whenever conditions permit, demands for a separate commissioner to administer these banks will

² Federal Farm Board, *Press Service No. 3-63*, released for publication Apr. 12, 1933.

undoubtedly be revived and the change could be readily accomplished.

Second, the new arrangements contain a threat to the future development of the Intermediate Credit Banks inasmuch as they are brought into close working relationship with lending institutions which render similar loan services but whose credit standards are far less strict.³ The Crop Production Loan Office and the Farmers Seed Loan Office of the Department of Agriculture make short-term crop production loans of an emergency character. As early as 1918 Congress made special appropriations of funds to be loaned to farmers in areas affected by flood, drought, or similar disasters.⁴ In 1932 and 1933 a portion of the Reconstruction Finance Corporation funds was allocated to the Secretary of Agriculture to be used for agricultural loans. Advances were for crop production purposes and to furnish feed for work animals and livestock.⁵ Collections on loans administered by the Secretary of Agriculture from 1921 through 1930 indicate that less than three-fourths of the principal

³ The same comment might be made concerning the Federal Land Banks and the Joint Stock Land Banks but in this study we are not directly concerned with mortgage lending institutions.

⁴ The federal program of seed loan financing from 1921 to 1932 inclusive required Congressional appropriations in eight different years and involved more than a million loans amounting to approximately 136 million dollars. Previous to 1932 loans were confined to specified areas affected by some disaster, but beginning in that year loans were to be made whenever "an emergency exists as a result of which farmers are unable to obtain loans for crop production."

The Farmers Seed Loan Office, which originally handled these appropriations, has had no additional funds since 1931 and is now engaged in making collections on loans previously made. The Crop Production Loan Office administers the funds allocated to the Secretary of Agriculture by the Reconstruction Finance Corporation.

⁵ A small volume of loans were made to individuals to aid in establishing or in strengthening local agricultural or livestock credit corporations.

amounts have been repaid. If later years were included the record would be less encouraging.⁶ These figures show conclusively that such advances are in the nature of emergency relief measures rather than sound credit transactions.

Unfortunately the loans made by the regional agricultural credit corporations organized by the Reconstruction Finance Corporation are also regarded as emergency advances, despite the fact that the Reconstruction Finance Act provides that all loans "shall be fully and adequately secured." Since these credit corporations obtain their capital from the Reconstruction Finance Corporation and rediscount paper with it, there is no obligation to private investors to maintain high credit standards. Whether loans will prove to be adequately secured in the sense that losses are relatively small and can be covered by their operating income remains to be seen. However, so long as they are looked upon as emergency credit agencies and not as a permanent part of our credit system, the tendency will be to extend credit more liberally than corporations rediscounting with the Intermediate Credit Banks are able to do.

The lending activities of the Federal Farm Board do not overlap the loan functions of the Intermediate Credit Banks to any great extent; but their non-banking, promotional character makes it highly desirable to differentiate sharply, for the benefit of the investing public, between such advances and the loans accepted by the Intermediate Credit Banks and used as security for their debentures. The loan services to co-operatives which are

⁶ *Congressional Record*, daily edition, Jan. 16, 1933, p. 1916.

⁷ Henry Morgenthau, Jr., "Merging Farm Credit Agencies to Simplify Procedure," *U. S. Daily*, Mar. 27 to Apr. 1, 1933, p. 16.

to be continued provide advances for educational purposes, for the purchase of facilities, and for effective merchandising.⁵ Such loans are not ordinarily acceptable to commercial banks and are not eligible business for the Intermediate Credit Banks. Since funds for these purposes are obtained from the revolving fund originally set up for the Farm Board, risks can be assumed that are not permissible for banking institutions which secure their funds from depositors or private investors. Whether unusual leniency in administering these loans to co-operative associations will have any ill effects upon the Intermediate Credit Banks cannot be readily determined, but inasmuch as the danger is present it would seem desirable to maintain credit standards which would leave no doubt as to the safety of the advances.

The urgent need for governmental economy has somewhat weakened objections to grouping agencies performing dissimilar loan functions under one authority because of its possible adverse effect upon the credit status of the Intermediate Credit Banks. Nevertheless, considerable care should be taken not to retard the development of our permanent agricultural credit facilities. It is imperative that the Farm Credit Administration maintain a sharp distinction between loans which must conform to conservative credit standards and advances which are justified only by the magnitude of the crisis which confronts agricultural producers or by the desire

⁵ Future stabilization operations are expressly forbidden in the executive order. No specific mention is made of supplementary commodity loans, but it would seem that they fall within the general category of "loans for effective merchandising" and that they will be made if the Farm Credit Administration finds that such advances are essential for an effective sales program.

See pp. 349-51 for a discussion of the effect of supplementary commodity loans by the Federal Farm Board on the Intermediate Credit Banks.

to develop rapidly a system of co-operative marketing associations.

The Farm Credit Administration could proceed upon either of two lines of action. It could place all of its credit transactions on a conservative basis as rapidly as possible and divest itself of all emergency relief functions. This policy would not necessarily eliminate any particular type of loan service to co-operatives but it would require that every applicant should qualify as a sound credit risk before advances were made. However, this procedure would be extremely difficult in respect to crop production loans inasmuch as in the past Congress has responded with alacrity to appeals for crop production funds for farmers affected by some calamity, and inasmuch as the regional agricultural credit corporations are expected to serve as emergency credit agencies.

A second line of action would be to assume that so-called relief loans to farmers who have no other sources of credit are inevitable, at least during the present depression, but to take all precautions to isolate such relief activities from the loan operations of the Intermediate Credit Banks. At the moment this second alternative is probably the only choice open to the Farm Credit Administration. However, in the interest of the future development of our agricultural banking system, the regional agricultural credit corporations should be developed as permanent financing institutions to connect producers with Intermediate Credit Bank funds and hence should extend credit only to well-selected credit risks.*

Inasmuch as the Farm Credit Administration will not

* The Crop Production Loan Office is authorized to advance 90 million dollars for production purposes for the 1933 season. This amount should provide for all the doubtful credit risks that the federal government undertakes to finance.

begin to function until May 27 and has made only preliminary announcements of its program, it is impossible to judge how successful it may be in creating a more effective credit service for agriculture. In any event, the record of the successes and failures of the Intermediate Credit Banks in granting short-term credits will help the new organization to formulate and carry out effective administrative policies.

APPENDIXES

APPENDIX A

DISTRIBUTION OF EARNINGS OF FEDERAL INTERMEDIATE CREDIT BANKS, FROM ORGANIZATION TO DECEMBER 31, 1932^a

Year	Earnings ^b	Carried to Reserve for Contingencies ^c	Franchise Tax Paid	Carried to Surplus
1923.....	\$ 306,755.59	\$ 2,213.19	\$ 152,271.20	\$ 152,271.20
1924.....	1,338,480.54	281,853.98	528,313.30	528,313.26
1925.....	1,175,655.63	158,475.90	508,589.86	508,589.87
1926.....	1,245,668.34	418,442.21	413,613.07	413,613.06
1927.....	1,029,671.03	292,119.28	368,775.88	368,775.87
1928.....	985,394.68	469,221.66	258,086.51	258,086.51
1929.....	1,379,557.29	1,035,096.17	172,230.57	172,230.55
1930.....	1,482,936.20	1,335,728.10	73,604.04	73,604.06
1931.....	1,396,357.28	1,353,768.75	21,294.27	21,294.26
1932.....	1,293,232.97	1,018,164.97	— ^d	275,068.00
Total..	11,633,709.55	6,365,084.21	2,496,778.70	2,771,846.64

^a Data for 1923-31 were arranged from the table in *Annual Report of the Federal Farm Loan Board*, 1931, p. 117. Data for 1932 were obtained from the Statistical Division of the Federal Farm Loan Bureau.

^b Losses are charged and recoveries are credited directly to the reserve for contingencies.

^c Amounts transferred from earnings and/or undivided profits.

^d Under the amendment of May 19, 1932 no franchise tax is to be paid until the surplus account is equal to the subscribed capital.

APPENDIX B

COPY OF LOAN APPLICATION

FOR ADVANCES UNDER SECTION 202 OF THE AGRICULTURAL
CREDITS ACT OF 1923, AS AMENDED, FROM THE FEDERAL
INTERMEDIATE CREDIT BANK OF BERKELEY¹

Dated: _____

1. The _____ hereinafter called the Applicant, a corporation organized and existing under the laws of the State of _____, with its principal place of business at _____, hereby applies to FEDERAL INTERMEDIATE CREDIT BANK OF BERKELEY, hereinafter called the Bank, for an advance to be made under authority of Section 202 of the Agricultural Credits Act of 1923, as amended, in an aggregate amount not to exceed _____ to be available to the Applicant on or about the following dates:

During the month of _____	\$ _____
During the month of _____	\$ _____
During the month of _____	\$ _____
During the month of _____	\$ _____
During the month of _____	\$ _____

Whatever balance of this credit is unavailed of by the Applicant on the _____ day of _____ 19_____ shall at the option of the Bank be cancelled forthwith.

2. The Applicant is a co-operative marketing association, organized for the purpose of marketing _____ hereinafter called the "product," and is composed of persons engaged in producing or producing and marketing the product. Applicant obtains title and power to pledge the product delivered to it by its

¹ The Federal Farm Loan Board does not require the several Intermediate Credit Banks to use uniform loan application blanks, but they are substantially the same.

members under the terms of its standard marketing agreement, a copy of which is attached hereto as Exhibit C. The Applicant undertakes and agrees that the product to be pledged hereunder has been or will be obtained exclusively from its members and not elsewhere, save that Applicant may at the option of the Bank pledge the products of non-members to which the Applicant has title and the power to pledge, but in no case may the products of non-members pledged or dealt with by Applicant be in an amount greater in value than such as are handled exclusively for its members.

3. Advances shall be made from time to time against the following described documents:

A. Note or notes of the Applicant in form attached as Exhibit E in an amount equal to the amount advanced, maturing at such time or times as prescribed by said Bank, payable to the said Bank at Berkeley, California, bearing interest at the rate fixed by the Bank and in effect at the time any such advance may be made, but not exceeding by more than 1 per cent per annum, as to each specific advance, the rate borne by the last preceding issue of Bank debentures, such rate of interest being approved by the Federal Farm Loan Board, said interest being payable quarterly.

B. As security for such notes negotiable public warehouse receipts covering the product, in form acceptable to the Bank, issued by independent public warehousemen approved by the said Bank, to show specifically the quantity and if required, the quality, of the product represented thereby, and to carry a marketable title to the product pledged hereunder, which title the Applicant will always protect against any claim whatsoever. Applicant shall arrange so that the Bank or the custodian may at all reasonable hours have free access to any warehouse in which the pledged product may be stored for the purpose of inspecting said product.

C. Insurance policies insuring the pledged product against such risks as the Bank may determine in an amount equal to the value thereof, in such form as to give the said Bank the benefit of said insurance to the extent of its lien in event of

loss, the insurance company or companies to be satisfactory to the Bank.

D. Certified statement of the secretary or other authorized officer of the Applicant, setting out, first, that the documents deposited with the Bank or custodian are free of lien and are deposited under the terms of this application and as security for loans made hereunder; second, a statement of the warehouse receipt number, tag number, marks, quantity and if required the quality and condition, insurance certificate number and market value, in accordance with the form attached hereto and labelled Exhibit K.

E. In the discretion of the said Bank, a statement signed by a representative of said Bank, approving the particular advances, the warehouse issuing the warehouse receipts, the form of warehouse receipt, insurance policy and other documents, and certifying that all requirements of said Bank have been satisfied.

F. If a custodian is used, the documents set out in B, C, D and E immediately hereinbefore set out, need not be directly presented to the Bank, but the latter will make advances upon receipt of custodian receipts in form attached hereto as Exhibit 3, executed by as custodian, certifying that it as custodian has received from the Applicant the documents and instruments therein described and enumerated as collateral security for the note or notes of the Applicant, the documents and instruments described in said custodian receipts to be in the form set out in B, C, D and E hereinbefore set out.

4. Upon the presentation to and deposit with the Bank of the notes of the Applicant and collateral documents as described above, or upon delivery thereof to the Custodian, if a custodian is used, advances will be made upon the following basis:

All advances hereunder shall be secured by pledge of warehouse receipts representing the product produced during the season, said product being of such amount and value that the advance does not exceed \$..... per, in no case to exceed per cent (..... per cent) of the net spot market value f.o.b. The burden shall be on the Association to

maintain at all times the margin of collateral herein required. Should the Applicant fail to maintain such margin, the Bank may, without notice to the Applicant, sell for the account and at the cost and risk of the Applicant, a sufficient quantity of the pledged product to restore the margin, applying the excess proceeds of such sales to reduction of the advance.

5. The Applicant agrees that no borrowings by Applicant other than those provided for under this agreement shall be made without the knowledge and consent of the Bank. It is understood, however, that the Association may borrow money from the Federal Farm Board, providing that such loans are junior to the loans made under this credit.

6. Inasmuch as funds are procured from the marketing of debentures to meet the Bank commitments, the Applicant promises that it will employ the funds herein applied for in the amounts and upon the dates herein fixed. Should the Applicant not do so, or upon pre-payment of advances procured hereunder, Applicant agrees to pay the Bank for such actual loss as the latter may sustain thereby, as determined by the Bank, to the extent that it will save the Bank from loss on outstanding debentures.

7. No credit shall be available either by way of original advances or renewals thereof while the Applicant is in default under this agreement or any other application or obligation to this Bank.

8. Collateral securing any indebtedness of the Applicant shall be security for any and all other indebtedness due now or to become due by Applicant to the Federal Intermediate Credit Bank of Berkeley under this application, or otherwise. Default in the performance under any other application or obligation to the Federal Intermediate Credit Bank of Berkeley shall entitle said Bank to declare the obligations under this application immediately due and payable and at the option of the Bank all property pledged under this application may be dealt

with as herein provided in case of default and any sums derived from the sale of property pledged hereunder may at the option of the Bank be applied to the obligations hereunder or any other obligations due from Applicant to the Bank in such order as the Bank shall elect.

9. The Bank shall release any warehouse receipts or shipping documents pledged hereunder representing the product and deliver the same to the Applicant upon payment on matured obligations of the loan value of the product at the time such product was pledged, provided that the Applicant shall not at such time be in default under any provision of this application or on any note or other instrument evidencing advances by said Bank; provided, however, that at the Bank's sole option it may require the application of the entire sale price of all the product sold until the loan is liquidated.

10. At the sole option of the Bank, the Applicant may withdraw shipping documents or warehouse receipts, and accompanying documents, representing the pledged product, or any part of it upon substituting shipping documents or warehouse receipts and similar accompanying documents, representing other of the product of a value at least equal to the value of the product withdrawn (the Bank reserving the right to reject any such warehouse receipts and/or similar accompanying documents not acceptable to the Bank), provided that the Applicant shall not at such time be in default under any provision of this application, or on any note or other instrument evidencing advances by the said Bank. In connection with each withdrawal the Applicant shall file a schedule of collateral, specifically enumerating and describing the documents to be withdrawn and the documents to be substituted.

11. On the day of, 19....., and on the day of each month thereafter until the advances hereunder are fully repaid, Applicant shall deliver to

the Bank a statement of its financial condition and of the amount of the product, both sold and unsold, on hand as of the last of the month next preceding. Applicant will also file with the Bank such reasonable periodic or special reports concerning its business as the Bank may require. The Applicant hereby expressly consents to a periodic examination of its affairs, including a complete audit of its books, records, and accounts, by regularly designated representatives of said Bank at such reasonable times as the Bank may deem necessary and proper, and agrees to pay the expenses incident to such examination as determined by the bank.

12. The Bank may appoint or designate one or more expert inspectors of warehouses, or through the Federal or State Department of Agriculture, or otherwise, appoint one or more inspectors of the product and through such inspectors physically examine the warehouses and the product involved herein, and Applicant shall at all reasonable times assist and facilitate the Bank in such examinations. Should said inspectors find that the product is deteriorating due to improper storage conditions, or to climatic conditions, or for any other cause, then the Applicant will upon demand of the Bank, have the same removed and stored under satisfactory conditions, and in the event that the Applicant fails to comply with this provision, the Bank may, at the risk and expense of the applicant, have the same removed and stored elsewhere, or sell at its option said product at public or private sale, without notice to the Applicant, and apply the proceeds upon notes held from the Applicant. The Bank shall not be liable for any deterioration which may take place with regard to any collateral which it may hold from the Applicant.

13. Applicant agrees to pay or cause to be paid to the Bank all reasonable expenses connected with the making of advances hereunder, including such expenses as may

be incurred for the account of the Bank by the custodian, if there is one, and including all salaries and expenses in connection with the inspection and examination of the warehouses and the products pledged, and the examination of collateral documents and the books and accounts of Applicant. Applicant hereby agrees to pay promptly when due all taxes, insurance premiums, duties, warehouse, freight and carrying charges and all charges and expenses which may or might become a lien on said property and which in any way might affect or cloud the first lien rights of the Bank in and to the property pledged hereunder. Should the Applicant fail to do so, the Bank shall be authorized so to do, and the Bank shall have a lien upon all collateral held by it until it shall be fully reimbursed for any advance which it may make in payment of any assessment, duty, tax or other charge which may legally lie against goods pledged to the Bank, together with interest thereon at the rate of 8 per cent per annum. The Applicant agrees that it will be responsible to the Bank for all expenses which may arise, or obligations which the Bank may incur, in connection with this loan, including all reasonable and necessary costs for the collection and enforcement of the obligation of the Applicant, or any outlay, for the protection of the Bank's interest in the security which may be pledged hereunder, even though no foreclosure or other legal action takes place. Loss arising from the negligence, insolvency or default of any custodian, agent or instrumentality utilized by the payee or legal holder of notes executed by Applicant hereunder or sustained in any exchange transaction, collection, enforcement proceeding, transmission of property and/or papers and/or remittance of funds, will be borne by Applicant.

14. The Applicant states and undertakes that no agreement has been made or will be made, to pay any person, firm or corporation, directly or indirectly, any

commission or fee for obtaining this advance from the said Bank, and that no such payments have been made or will be made by the Applicant apart from reasonable compensation for legal services. The Applicant further undertakes and agrees that the proceeds of this credit shall not be used for the purpose of speculating, or of obtaining a fixed market price, or for the manipulation of the market, but the sale and shipments of the product shall be made in the ordinary course of trade.

15. If in the opinion of said Bank the Applicant is not marketing with sufficient rapidity the product owned by Applicant, the Bank may call on Applicant to accelerate its sales. If the said Bank's request is not complied with, the said Bank shall itself, without notice to the Applicant, have the right to sell, from time to time, out of the product pledged as collateral, a sufficient amount to meet such a requirement. In the event of any such sales, the said Bank may, in its uncontrolled discretion, apply the entire net proceeds to the liquidation of its advances.

16. The Applicant warrants and covenants that it has full power and authority to arrange this credit, to receive the benefits thereof, to hypothecate the security in accordance with the terms hereof, and to execute and perform on its part this agreement in every particular. The Applicant warrants and covenants that it is and will be the owner of all the products represented by warehouse receipts pledged hereunder, and that all of the product hypothecated hereunder is and will be free and clear of all liens and claims of every kind whatever, except such warehousemen's liens as shall be specified in the warehouse receipts or other documents evidencing the product.

17. No express or implied waiver by the Bank of any default hereunder shall in any way be or be construed to be a waiver of any further or subsequent default of the Applicant, or a waiver of any of the rights of the Bank

under the terms of this agreement, or a modification of any of said terms or any extension or enlargement of the rights of the Applicant hereunder.

18. The bank shall be protected in acting upon any notice, request, consent, certificate, writing, resolution or other paper or document believed by it to be genuine and to have been signed, executed, passed or presented by the proper parties. The Bank shall not be liable under this agreement for any matters connected therewith if it shall act in good faith in performing the obligations by it expressly assumed; and obligations not herein expressly assumed shall not be deemed to be implied.

19. Should the Applicant default in any provision of this agreement, or in the payment when due of any obligation from it to the Bank when due on the face of the obligation or declared due under the terms of this agreement, or fail to maintain the margin of collateral required by this agreement, or commit any act of bankruptcy or insolvency, the Bank may, at its option, declare any or all obligations from the Applicant to the Bank due and payable, and may thereupon sell any or all collateral held by it from the Applicant together with any and all brands and labels and the right to use on said pledged collateral any and all brands, labels, trademarks and trade names owned and used by said Association until said collateral is entirely marketed by the Bank, or any purchaser, at any public or private sale, with or without demand of payment, or notice of intention to sell, or of the time and place of sale, for such price as it may deem fair, giving clear title to any property so sold without right of redemption. The Bank may be the purchaser at any such sale should it so desire. The proceeds of any sale shall be applied, first to the expenses of the sale, including reasonable attorney's fee, second to the obligations owing the Bank, and third to the Applicant, should there be anything left after the expenses of the

sale have been paid and the Bank has been paid in full all obligations owing it from the Applicant. Nothing herein shall be construed to prevent the Bank from holding the Applicant for any deficiency which might remain after a sale as above set out. Nothing herein shall be construed to impair the Bank's right to obtain relief against the Applicant through the courts should it so elect. In the event of any legal proceedings against the Applicant, the latter agrees to pay all costs and reasonable attorney's fees incurred by the Bank.

20. Applicant through its authorized officers has read and is familiar with this application and has read and is familiar with the Agricultural Credits Act of 1923 and amendments thereof, and with the Rulings and Regulations of the Federal Farm Loan Board; Applicant agrees that all of the requirements of said Act and of the Federal Farm Loan Board as expressed in its Rulings and Regulations already made, or which may be made during the life of this agreement shall be a part of this agreement as though set forth in full herein, and Applicant shall be bound thereby.

21. This agreement and all the terms hereof shall be binding on the parties hereto and their lawful successors in interest. An assignment of this agreement or any interest therein by the Applicant, without the written consent of the Bank, shall be without any force.

22. Upon acceptance thereof by the said Bank, this application shall be and become a contract between the Applicant and said Bank, subject to the approval by the said Bank of all notes, drafts, warehouse receipts, insurance policies, or other documents, submitted herewith, or to be hereafter submitted, in accordance with the terms of this agreement.

23. Applicant agrees that no progress or final payment shall be made to members of Applicant's co-operative corporation so long as any product of the members

shall remain pledged to the Federal Intermediate Credit Bank of Berkeley to secure this or other applications or obligations to the Bank, unless the Bank first consents to said progress or final payment.

24. Applicant represents that all warehouse receipts, bills of lading or other documents representing the product deposited with the Bank or the custodian will be made in the name of the Bank, but Applicant hereby expressly authorizes the Bank or its duly authorized custodian to indorse any warehouse receipts, bills of lading or other documents representing the product deposited by the Applicant to secure loans made under this application, and with the same force and effect as though the indorsement of the Applicant had been placed on any of said papers by a duly authorized officer of Applicant.

25. The Applicant makes a part of this application, the following documents:

Exhibit A—Certified copy of the Articles of Incorporation.

Exhibit B—Certified copy of By-Laws.

Exhibit C—Copy of standard Marketing Agreement with statement certifying the number of such marketing agreements with members now in effect.

Exhibit D—Statement indicating what changes, if any, have been made in the Articles of Incorporation, By-Laws and Marketing Agreement since date of previous application.

Exhibit E—Form of obligation.

Exhibit F—Opinion of counsel for Applicant, certifying:

- (1) That the Applicant is authorized by law to incur the liabilities involved;
- (2) That the officers who will execute the note or notes of the Applicant are duly authorized by legal and corporate action so to do and are similarly authorized to pledge or hypothecate the collateral security which will be offered;
- (3) That each note when executed on the form

attached to the application as Exhibit E will constitute a valid and binding obligation of the Applicant according to its terms;

- (4) That the Applicant will obtain marketable title to the product delivered to it by its members under the terms of its marketing agreement (Exhibit C), with full power to pledge such of the product to the said Bank so that it will be security for any and all notes of the Applicant to the said Bank outstanding under its said application.

Exhibit G—List of warehouses which will be used by Applicant with specific information relative to the licensing and bonding of the warehousemen.

Exhibit H—Resolution authorizing borrowing.

Exhibit I—Certificate of election or designation of present incumbency of principal officers, with specimen signatures.

Exhibit J—Certified copy of financial statement of recent date.

Exhibit K—Schedule of collateral.

Exhibit L—Questionnaire.

Exhibit LI—List of brokers and selling agents.

Exhibit M—Schedule of advances.

Exhibit N—Opinion of counsel for Bank.

In case a Custodian is appointed for the purpose of keeping safely and handling efficiently collateral documents and credit instruments pledged or employed by the Applicant to secure any advance or advances made to it by the Bank, then Exhibits 1, 2, 3, 4 and 5 shall be submitted as part of this application:

Exhibit "1"—Custodian Agreement.

Exhibit "2"—Designated officers of Custodian in charge of collateral pledged, with specimen signature of such officers.

Exhibit "3"—Schedule of collateral, Borrower's Certification of Pledged Collateral and Custodian's Receipt.

Exhibit "4"—Schedule of withdrawal.

Exhibit "5"—Opinion of counsel for Custodian Bank, certify-

ing that it has trust powers and authority to act in the capacity intended by the Custodian Agreement.

IN WITNESS WHEREOF, the parties hereto have affixed their hands and seals the day and year first above written.

(SEALS)

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