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BEFORE discussing the problems of the production credit system a brief background, at least, is necessary in order that the stranger may understand, in part, the organization that from necessity has grown up in America. It is assumed, however, that most people are somewhat acquainted with the credit system that has been established to assist in financing farmers in the United States, and consequently but little detail will here be given.

The Farm Credit Act of 1933 created the Farm Credit Administration with four financing divisions. These divisions, or farm-financing agencies, are: the Federal land bank, which has operated successfully since its organization in 1917 and deals with farm mortgages or long-term loans; the Federal intermediate credit bank, which discounts the farmers’ collateral and obtains its funds through the sale of bonds and debentures to the public; the bank of co-operatives, extending credit to those organizations owned and controlled by the farmer; and the production credit bank, dealing in short-term credit, such as crop and live-stock loans which are repayable within a few years at most and more generally within the crop season.

The production credit system consists of a Federal Commissioner and deputies with headquarters in Washington, a production credit corporation with its supervisory officers located in each of the twelve regional districts into which the United States is divided, and the production credit associations farmer-owned and controlled, of which there are more than 550 located throughout the important agricultural areas of the United States.

It is a non-profit organization from which any farmer who has a basis for sound credit can obtain a loan at a reasonable rate, repayable at the time the crop or livestock for which the loan is negotiated is marketed. Each borrower is a member and purchases stock in his local association at the time his loan is made. He has one vote as a stockholder. In slightly less than three years of operation the 550 production credit associations in the United States have loaned to 212,970 farmers $404,557,192 (May 31, 1936).

Now as to the problems this agency faces. One does not need to
say that they are many and varied, for anyone with little imagination and less experience can visualize many of the difficulties to be encountered in extending credit to any farmer having reasonable security, living anywhere in the United States, and engaged in any kind of farming; add to this also the equally difficult task of collecting the loans made during this particularly difficult period when our agriculture has been so out of balance, and one gets a picture of some of the problems involved.

Of course, the matter of personnel is an important one. Given able officials, experienced loan committees, and efficient and trained inspectors, many other problems become secondary. Many other difficulties would also disappear if all associations had a satisfactory volume of business, consisting of a high percentage of good loans. However, these are two problems common to almost any financing organization. For this reason they have, along with others of a local or less important character, been omitted from this discussion.

Those problems which seem to be the larger and common to the entire system will be described in the following paragraphs. Production credit officials, farmers, extension directors, and economists have been approached to secure their views. The eight problems presented and the solutions proposed in no small part represent their offerings.

1. Quickness of Action. One of the most immediate problems facing the production credit system is that of rendering quicker service. Farmers want to get money quickly, after they have decided to apply for a loan. No matter how dilatory they have been in making the application, they expect a public agency to render immediate service. They may pay the cost of the original investigations and subscribe for their class B stock without objection if the service is prompt and efficient. Yet they become impatient when additional investigations or delays occur.

The farmer also must build up a more accurate and dependable system of records as well as establish a sound debt-payment record if he is to expect a quicker and more satisfactory service. Greater responsibility for decisions is being placed, and must be increasingly placed, upon the loan committees and officers of local associations. This, more than any one thing, will quicken action. Farmers, secretary-treasurers, loan committees, and bank officials are all aware of the 'red tape' that is now a part of the system.

Regarding the elimination, or at least reduction, of this so-called red tape, Mr. H. B. Munger, President of the Production Credit Corporation in the First District, says: "We have made some progress in simplification. Much remains yet to be done. As we come to
have a number of years of satisfactory experience with a farmer, I hope that we can accomplish much more in this direction. A reduction in the number of forms used and a simplification of the ones that are used will materially cut operating expenses and improve the service to farmers.

The problem, then, is one of constant improvement in the mechanics of making loans so that the service may be as prompt, courteous, and sound as farmers may receive elsewhere. Patience will be needed while the system is establishing an efficient and workable procedure and developing sound credit experience.

2. Flexibility to Meet Individual Conditions. There is a tendency for any agency whose officials are not actually acquainted with the applicant for a loan to follow a set formula regardless of the financial position of the borrower. This procedure will require mortgages, waivers, subordinations, crop liens, and other details that greatly restrict flexibility. The good farmer objects to this and to the theoretical checking and averaging of conditions upon which his individual loan is approved. He feels that the farm is his, managed and operated by his understanding and experience which has taught him the best way to get results. He objects, when his security is ample or his reputation for debt payment good, to having a plaster placed on all real estate and chattels and otherwise to being subjected to the same restrictions that are required of the applicant with less security and not quite as good a debt-payment record.

The past year has seen a remarkable improvement in the flexibility and the treatment of each case on its own individual merits and conditions. As inspectors become better trained and as loan committees develop good credit judgement, restrictive procedure can be withdrawn and the system made more flexible—at least for the applicant who has established a good debt-payment record and who is yearly in need of production credit.

3. Present Favourable Credit Situation may not Continue. The money market is now very favourable to the borrower and, therefore, it is an extremely favourable time for a new loaning agency to become soundly established. If high interest rates later prevail in the money markets, then it is entirely possible that borrowers may be charged a higher rate of interest, possibly 7 or 7½ per cent., unless, during these favourable times, credit agencies place themselves in a position where they can reduce the 3 per cent. spread now prevailing. Should the higher rates prevail and no reduction prove possible in the present 3 per cent. rate, then a problem presents itself in holding the better class of borrowers.
Moreover, when normal conditions return, mortgagees will want reductions on the principal of their mortgages, where indulgence has been shown and only interest has been required. This, together with other fixed charges and needs which the farmer faces, will make it difficult to maintain a favourable debt-payment record unless an unusually favourable price situation for the products he has to sell should prevail.

In other words, the present margin between wholesale and retail credit rates is most favourable and it would seem to be an opportune time for credit agencies to put their house in order, reduce carryovers to a minimum, build reserves, if possible, and in all cases develop sound loaning and collection methods.

4. Loyalty or Sense of Ownership. Most co-operative enterprises have been established only after the ground has been thoroughly worked and the people concerned thoroughly informed. In many instances people have, during this organization period, contributed their time without thought of recompense because of their belief in the venture. Such efforts or campaigns have not only informed a great many people but have brought to light those individuals, committees, and groups possessing an interest in the enterprise and developed a sense of loyalty to it. This has been a big factor not only in bringing about the organization of the agency, but in supporting it when weather became rough. Moreover, the people invariably connected with such efforts are the real leaders in their communities as well as the best and most respected farmers.

The production credit system missed this experience. It was brought into being through an Act of Congress. Because of the financial condition of our farmers and of the country, it was utilized by large numbers who had no interest in the system or even desired to be associated with it. There was no sense of loyalty or ownership connected with their first affiliation; dire necessity caused them to turn to this source of credit. The production credit system will be faced with a difficult task to develop this sense of loyalty or sense of ownership so necessary and characteristic of successful co-operative enterprises.

In respect to this problem Dr. F. A. Harper of Cornell University says: ‘It is going to be a difficult job, in an organization where the contact between the agency and the member is as infrequent as is the case with short-term credit, to maintain a sense of ownership in the co-operative organization. This sense of ownership is very important in retaining volume of business and in keeping adequate participation on the part of members so as to insure continued good management and local efficiency.’
5. **Over-Extending Credit.** Many of our production credit associations during the first year of their existence over-extended credit. This was due in part to lack of credit experience, but more generally due to the non-recovery of business, or the production of surplus products that could not be sold, or other factors outside of the amount loaned. The experience, however, was so general and has been so painful ever since that one would expect great caution on the part of short-time loan agencies.

However, another situation of an entirely different character is now in the making, that may be equally costly unless foreseen and guarded against. This problem is the increasing cost of things the farmer has to buy which, as prices reach the peak, may leave the loaning agency holding the sack if prices tumble precipitously. In other words, the increasing cost of farm equipment, dairy cows, grain, fertilizer, and, in general, any merchandise purchased by the farmer is one of the serious problems before production credit agencies to-day.

While it may have been a sound policy, during the period when the farmer was paying low prices for the merchandise he bought, to loan 50 per cent. of the cost, with rising prices it may not only be unwise but prove disastrous if the same percentage is continued. To loan 50 per cent. on cows selling for $50-60 is one thing, but to loan money on the same cows at $150-200 is quite another risk.

6. **Accessibility of Loan Office.** There are approximately 550 production credit associations in the United States. The area served and volume of business done varies tremendously as would be expected during the formative days of such an agency. One of the largest associations has loaned approximately $3 million, while several have loaned less than $100,000. The area served in one instance may be small enough to make the loan office accessible to all farmers of that area, and in another instance larger than one or more States combined, so large in fact that the farmer may never visit the loan office. During the first few years, at least, the absence of a set formula is desirable, basing future programmes upon experience. However, there is a decided feeling that, volume of business permitting, the borrower should have easy access to the loan office.

Four officials of the production credit system have expressed themselves as follows on this point: (1) ‘To reach the better class of farmers in outlying territories is a real problem and some method of further localization must be developed.’ (2) ‘I believe there should be a tendency to decrease the area which each association serves. Many of them are now too large. A good farmer does not have to
travel 100 miles to get a loan.' (3) 'I believe that many other problems would naturally disappear if associations could be developed to the extent desired. It would have the tendency to do away with inefficiency. It would help greatly in the time-limit of any individual loan, and to quite an extent decrease the amount of "red tape".' (4) 'Another problem is the location of loan offices to make this service more available than it is at present. I would not be interested in making a couple of eighty-mile trips to borrow a few hundred dollars at 5 per cent. if I could borrow it at 7 per cent. locally. I believe there is need of more associations in order that the service to the farmers may be increased.'

There would seem to be at least three practical ways by which this objective could be attained, trying different methods and then utilizing those which seemed best adapted to the conditions prevailing.

(1) Develop to some greater extent than at present the so-called outposts. Here the person in charge would take applications, make inspections, and possibly do general servicing, but would not be responsible for making loans. (2) Appoint assistant secretary-treasurers who would serve the outlying areas of the larger associations. These assistant secretary-treasurers would take applications, make inspections, close loans, and do general servicing in a localized area. (3) Where the volume of business is sufficient, divide the territory now being served and organize new associations.

7. Education Needed. One of the real needs for education is to correct misunderstandings as well as to impart new information. As previously indicated, the production credit system was created by an Act of Congress. This occurred at the same time as many temporary or emergency agencies were also born, with the result that a great many farmers, and certainly the public in general, considered this another Federal bureau furnishing government relief. While farmers no longer think of it as a relief agency, not so the public, who still regard it as 'government money' that is being loaned.

An extension farm management specialist says about the need of education: 'Most of our farmers who understand thoroughly the problems of our production credit associations are strong backers of it. However, I have met farmers who through lack of information have criticized the existing policies. This again makes me believe in the need of a lot more educational work in regard to our existing agencies that are extending short-term credit.' There is also the necessity of developing the goodwill of public bodies and establishing better relationships with other loaning agencies. This can be
done in various ways, but the tendency may be to delay or ignore the
interest and desire for information on the part of others in the rush
of work. Every employee should feel himself a public relations
man and do his best to create and maintain goodwill.

A second need of education is to be found in the large number of
potential borrowers who are now using merchant credit. This credit
is usually very expensive, costing 15 to 20 per cent. on the money
borrowed. The farmer borrows from the merchant sometimes because
of his inability to get money elsewhere, but in certain instances be-
because he is uninformed as to the advantages of other sources of credit,
or because he possesses insufficient knowledge of how to proceed in
securing such. An extension economist in one of the potato areas
of the east indicates that 80 per cent. of the farmers in one county are
using dealer credit for the purchase of seed and fertilizer. He further
states that in an adjoining area only 7 per cent. applied to the produc-
tion credit system for loans, while in another potato area nearby
only 4 per cent. applied. It would seem in such cases that proper
information would prove helpful to the production credit system
and the farmer.

One secretary-treasurer, with twenty-five years of educational back-
ground, has this to say: 'I believe that the greatest problem confront-
ing us at the present time and in the future is the educational aspect
of this work. In addition to having the farmers understand the system,
it is vitally important that the wives of these men become interested
and attend the stockholders’ meetings. A programme should be
worked out also that would reach 4-H clubs and other juvenile
organizations.'

Again, there is a third need for education in the wise use of credit.
As one secretary-treasurer has so well said: 'Credit used correctly
can be a wonderful asset, but credit used incorrectly can be a real
liability.' Our secretary-treasurers, our loan committees, and our bank
officials must themselves safeguard to a considerable extent the cor-
rect use of credit. Our colleges of agriculture and the extension
service can and should assume more of the educational work dealing
with the wise use of borrowed capital.

8. Financing Hazardous Types of Farming. Of the 550 production
credit associations in the United States only six or seven have had an
impairment of their B stock. This impairment has been wholly or
largely confined to hazardous types of farming in the fruit and vege-
table areas where violent fluctuations in prices have occurred. The
answer to this problem has not been found, but all can agree that
credit cannot be extended in the same manner here as in other areas
if the spread is to remain the same, 3 per cent. Other agencies have failed even with 10 to 15 per cent. spread.

A solution can be found. It will probably be different for each commodity or area served. At least the Farm Credit Administration should employ different methods in these hazardous areas and not be too greatly disturbed if they do not each work out 100 per cent. perfect the first time employed. (1) It may be that the amount of credit can be restricted so that the loans per acre are small, though pressure groups and a few years of low prices make this plan sound difficult; (2) it may be possible to create reserves to help to take care of losses on this type of loan; or (3) there is some possibility of controlling the security, i.e. the crop produced, and marketing this through an agency approved by the Farm Credit Administration. The last method, at least, has been tried out in a very thorough and extensive manner this past crop year by one of the largest associations in the system. Much good has resulted from this experience, to the association, to the borrower, and to the area served.

As previously indicated, efforts to find the solution to this problem should not be confined to one particular method, but the plan which seems the best adapted to the particular commodity or area should be given a thorough trial.

In conclusion, extracts from certain letters received will be quoted to indicate, in general, that underneath all the problems which production credit faces, the 'man in the street' is thinking favourably of the system. The following are a few of the statements that have been made:

'... being a farmer I know that this production credit service is one of the most outstanding services ever rendered the farmers. During the past few years of depression when the agricultural class really did have need of some financial assistance, the banks failed them.'

'Our business this year decidedly indicates the growing confidence in the minds of the agricultural people with respect to our production credit associations. A better class of borrowers, who were reluctant to come to us at first, are now doing so, and they seem to have a sincere appreciation of the service we are rendering.'

'From my contact with farmers I would say that the production credit system meets with their whole-hearted approval. It is the first time that many of them have been able to borrow from a loaning agency at a reasonable rate of interest. It is the first time that practically all of them have been able to borrow on a repayment plan timed to fit their particular income. The most frequent comment is that it is a godsend. There has been some criticism, but it has to do more with the mechanics of the system and is of a minor nature. These are being corrected.'
I am very glad to have had the opportunity of listening to the papers given this morning and I have learnt a great deal from them. On a visit to the U.S.A. in 1930 I tried to acquaint myself with their credit system in the limited time at my disposal.

There are two points which I would like to refer to regarding this morning’s papers. The first is to make a distinction between ‘production credit’ and ‘consumption credit’. The other is to mention the outflow of capital from the countryside to the towns.

In Germany we try to keep agricultural credit at as low a level as possible and to avoid it, if we can. The farmer or peasant should earn enough in his lifetime to be able to do without other money. The need for credit is not, however, entirely eliminated. We wish that, as far as possible, the farmer should demand only ‘production credit’. There will always be a call for it, if openings are to be found in farming for capable young farmers without means of their own, and it will always be required when large innovations in farming are to be made. That is the position as it occurs in all countries. But is not a great deal of the credit flowing into agriculture to-day ‘consumption credit’, used only to pay off old debts which have arisen partly because the farmers had spent too much or earned too little? ‘Consumption credit’ can chiefly be restricted, as Dr. Windirsch has said, by seeing that farming remains profitable. But it will also be dependent on our being able to make the farmer efficient, so that he understands his job and is capable of getting yields from his land that can cover expenses.

Turning now to my second point, I wish to refer to the outflow of capital from the countryside. If I may use the example of myself, I may assume that part of the capital invested in my education was ‘productive’. This capital all flowed into the town and only partly does it benefit the countryside in the form of education of the farmers. This ultimate destination of rural capital has already been mentioned in one excellent paper, and it was pointed out that if all capital formed in the countryside remained there a large portion of the agricultural credit requirements could be met by this capital of rural origin.

What is the destination of capital of rural origin? I cannot review all countries, but briefly what has happened in Germany is that people leave the country for the towns and that industry flourishes
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on the fine men continually being given by the countryside. Not only have these people left the country, but with them the capital spent on their education is lost to the countryside. Not only is this capital lost to the countryside, but also the capital they took with them in cash settlements or in equipment. Very substantial sums are thus permanently lost to the countryside and must continually be replaced. Again, farmers and peasants, at any rate in Germany, did not, as long as they had ready money, always reinvest this money in their farms; to a great extent they placed these sums at the disposal of industry by buying shares, not only German shares, but to a great extent also foreign shares, as, for example, the large sums invested in railroad shares in America and other countries.

One other point I would like to add. There is one respect in which we are in a worse position than America. It struck me when I visited that country in February 1930, after the crash on the stock exchange of 1929. In travelling through the country, I noticed that many farms were in the hands of life assurance companies. This was for me quite a novel feature, for I know—and have proved it by inquiries—that our German insurance companies invest scarcely any part of their capital in rural mortgages, but rather invest it all in urban and industrial mortgages. In this manner also, much of the capital created by the peasants in the country is lost to the countryside. I think that these aspects of the problem well merit a certain consideration in our discussions here.

C. R. Arnold, Deputy Production Credit Commissioner, Farm Credit Administration, Washington, D.C., U.S.A.

There are just one or two things that I would like to mention, since I have been asked to make a remark or two here, and we have only a few minutes before time to close the session. These are going to be based largely upon the questions which came to me during the last intermission, and they are confined to just a little further explanation in regard to some of the mechanics or the operations of the one phase, short-term credit, in which I am specially interested and happen to be working with at Washington.

I have been asked if this programme is new. It is new in the United States, and I presume somewhat new generally. The first production credit associations in the United States were organized three years ago. In the short-term production credit system in our country, no loan is made for a longer period than twelve months. One of the questions asked during the intermission was in regard to who makes the loans. Our office in Washington, the production
credit division, cannot make a loan; neither can these production credit corporations, twelve of which are scattered over the country. All of the loans are made by the local associations described by Dr. Hill. They have a board of directors elected by the farmers themselves, and are not under political control. The money is paid out of their own funds. The rate at which they make loans is set at a certain percentage above the rate which they pay the intermediate credit banks. The local people have the final say in regard to all loans. This is an attempt to make it as nearly as possible, and as quickly as possible, strictly farmer-owned and at least farmer-controlled.

Another question was asked about the B stock that has been referred to. I will not go into any details of that as it is a little complex, but I will just say this. The sum of $120 million that was appropriated by the Federal Government was placed in bonds and is used as additional collateral in borrowing from the intermediate credit bank when these farmers’ notes are discounted. The B stock is the stock the farmers’ own, and must equal 5 per cent. of the amount borrowed. The stock which the Government or corporation owns is the A stock mentioned in the paper. The latter carries no voting power. When any bad loan is made and any loss is sustained, it must come out of the farmers’ B stock. Losses must first be taken out of the farmers’ stock until the association is completely wiped out, before any loss is sustained by the Government money at all. There happen to be eight of the 356 associations in the country which have sustained some loss up to the present time. These were referred to by Dean Deering. In each instance that loss has been taken right out of the stock that the farmers themselves put into it, and must be rebuilt before that association can set up reserves.

Only one other point. At the present time there are something over 200,000 members of the production credit system in the United States, approximately one farmer out of every thirty in the country. The point that was emphasized this morning, namely, that these people may be members because of necessity rather than members because of their co-operative desire, is a very essential one. This system of production credit will live or die largely on the point that Dean Deering emphasized regarding education and the necessity of having farmers understand the need of developing their own short-term credit system to take care of them during bad times as well as during good times. Very much depends upon the educational phase, and I am sure that in our experiment of the last three years we have not gone as far with the educational work as we should. This past
year, mostly during January and February, every one of these 556 local associations in the country held an annual meeting. Over 80,000 farmers attended these meetings at which a definite educational programme was presented. An attempt is being made to develop the educational phase of that programme which is absolutely essential for the success of the production credit system.