Commentary

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The scenario presented by Emanuel Melichar has established a rationale for the seasonal borrowing privilege and the administrative guidelines that go along with the privilege. There has been a strong view expressed in years past that the Fed should play a more prominent role in providing loanable funds to agriculture. This applies especially to those banks that lack ability to access the national markets during times when we have also seen seasonal volatility in bank deposits as well as seasonal swings in loan demand, and at a time when correspondent banks did not prove to be a reliable source of funds during periods of monetary restraint.

It seems to me, during the many years that I have been involved in banking, that we have had a fragmented and undreliable system of supplying loanable funds depending almost solely on deposit growth.

At this symposium we are talking primarily about loanable funds to agriculture. You will recall that Emanuel examined the factors that influenced qualification for the borrowing privilege, including the differences between agricultural and other banks. Some of the factors affecting the amounts and patterns of borrowing are changes in seasonality and guidelines, changes in bank liquidity, and changes in relationships among the relevant interest rates, that is, the rates of borrowing on alternative sources of funds and on loans being made.

A question is raised as to why qualifying banks, for some reason, use their seasonal borrowing privileges more in some years than in others. I see three basic reasons:

1. Profitability of making loans from funds obtained at the discount rate.
2. Changes in bank liquidity positions.

3. Changes in the relationship between the discount rate and rates on alternative short term funds.

In examination of our region, there would not seem to be a relationship between seasonal borrowing and the discount rate. During periods of monetary restraint, we have seen a higher discount rate, a decrease in the money supply brought on by Fed action, and a corresponding decrease in the liquidity of some banks, producing the necessity to access the Fed or some other source of borrowed funds.

Banks have provided for seasonal outflows of funds by storing "seasonal inflows" in the form of liquid securities to be sold to meet the subsequent outflow. We will probably see more liquidity held in banks to meet future credit demands, unless a dependable source of borrowed funds can be found to fund the loan demand when it comes. I might add that during periods of high liquidity in banks, it has not been their role to solicit additional loan business to use up that liquidity, but rather to take care of their normal demand and build back liquidity in anticipation of future heavy borrowing. This behavior has been caused by apprehension about the availability of funds in the secondary market in the event of a credit squeeze.

Emil Melichar has discussed at some length situations in which seasonal borrowing appeared to be surprisingly small. There are several reasons for this. For example, I do not feel that seasonal borrowing has been encouraged by the Fed to the degree suggested.

The country banks have become somewhat more sophisticated in accessing the money markets through improved correspondent bank relations. At the same time the larger banks, the regional correspondents, have developed more sophisticated ways of accessing national and international markets and have become a more assured secondary market for agricultural banks.

More recently, money market certificates have become an important source of funding for rural banks, and we need to be aggressive in our retention of these funds. However, it may seem at this time that we are nearly out of the ballpark when we look at the relationship between the cost of these funds and the pricing of our agricultural loans. Nonetheless, we should look at the blend of money, average our cost, and aggressively retain these funds in our respective banks.

I do not believe we should rely a great deal on Fed funds because of the volatility of this market. But we will see more realistic swings in typical farm loan rates as well when we use variable-rate notes. That relates to change in the cost of funds—that is, local deposits of banks—which rise and fall with national rates. To permit this adjustment in loan rates, there needs to be a concerted effort on the part of all bankers to remove usury statutes. It is equally important to encourage wider use of asset and liability management, to know the costs of money and where to price the product for the desired spread.

If agricultural banking is to serve rural America as it should, we need reliable sources of funds in the secondary market. Ag banking should be a viable, competitive force, but there is a need for bankers themselves to be more aggressive, to utilize the tools and the expertise available to maintain the desired share of the market. The future demand for agricultural production will rise to new levels of importance in coming decades in the United States and around the world. While it is not probable, nor even possible, for the United States to feed the world, it is incumbent upon this country and other wealthier nations to try harder to upgrade the overall standard of living of the developing nations. That certainly calls for increasing our agricultural production.

Farm commodity demand will rise 1-3 per cent a year on the average in this country; biggest gains will be made in overseas sales. World population is growing every day, and living standards continue to increase in places like Japan, Eastern Europe, the Middle East, and Russia, all of which will stimulate the demand for more and better livestock products. Therein lies an opportunity for sale of our feed grain in the export market and an improved opportunity for American agriculture.

The number of farms will keep shrinking. However, most farms will continue to be family farms as opposed to the corporate structure with outside ownership.

Financing agriculture has changed immeasurably since the years of the hip-pocket banker. As agricultural lenders, we anticipate increased demands for money to finance this industry in the future, including:

1. Larger operating loans due to inflation's effect on goods and services.
2. Larger farms requiring larger credit lines.
3. Reduced margins in agriculture, along with higher capital costs, putting considerable pressure on cash flow in agriculture.

All this has come about during a time when margins were being depleted in banking by higher loan-to-deposit ratios, less liquidity, and lower capital ratios. The result has been that lenders are more selective when selecting customers and are working with those customers who best manage their land, labor, and capital. There is growing competition among the banks, PCA's, and others for this business. As bankers, we need to use all the available techniques to put together sound loans and carry our borrowers through periods of uncertain prices and prolonged drought. With good planning and a source of funds, bank lenders will be a dependable source of credit.

There are adequate dollars in the financial system to finance the agricultural business, but all banks must carry their share of the load, be aggressive, utilize the tools that are available through their correspondent banks—and, when possible, pass loans to the secondary market.

Agriculture has been a major strength in this country, and it is truly exciting to look to the '80s and beyond. We have the highest level of expertise in the world in the production of food and fiber, and a strong demand exists in foreign markets.

Banks will need to exert a major effort to keep their agricultural business. A recent Department of Agriculture survey of commercial banks confirmed that farm loans from banks are becoming less available. And one of the reasons stated was that funds available for lending were not sufficient to fill the demand. Fully 20 per cent of the responding banks said that they had denied loans or had granted smaller loans than requested because of a shortage of loanable funds in 1978 and 1979. As a result, more and more farmers may be forced to locate and secure loans from lenders they have not dealt with before. But banks are still in the ballgame. This same report, prepared by the General Accounting Office for the Secretary of Agriculture, shows that the Farm Credit System has a total of $40 billion in loans, both real estate and non-real estate, or 30 per cent of the market. Commercial banks have $36.8 billion, or 27 per cent of total loans; however, in the non-real estate area, banks held 43 per cent of the loans, with the Farm Credit System second with 24 per cent.

It was noted in this report that there were several advantages to doing business with the PCA's, including low interest rates; availability of funds, farm lending specialists, and line-of-credit financing; an understanding of farmers' needs; the fact that the system is operated by farmers for farmers with one interest rate for all borrowers; counseling for effective farm management; and record-keeping services.

Advantages cited for doing business with banks include fast service, convenience, full service, simple loan procedures, and fixed interest rates. Bankers should be able to add other advantages, such as the fact that banks are a dependable source of credit, that they have farm lending specialists, that they have package financing to fit the farmer's needs, and that they offer record-keeping services and estate planning. There must be many more.

Bankers in rural America have an opportunity to generate deposits through money market CD's, NOW accounts, savings, and others, even though we will have much greater competition in the future.

It is imperative that we make customer calls, market our services, and provide dependable service through bad times as well as good, sell the full-service concept, and, above all, utilize participation privileges for overlines with a source that is dependable. The Fed should play a major role in this, as a source of funds to commercial banks through the seasonal borrowing privilege.

Another important consideration for banking is our competition in the '80's. The Farm Credit Act Amendments of 1980 present a serious challenge to the long-run viability of banking institutions to serve agriculture. We'd better come out of the chute with a deep seat, a long rein, and hang our spurs in pretty tough. What I mean is, if we don't make a solid effort not only to retain, but to expand our business in agriculture, we're "gonna get throwed." The Farm Credit Amendments would allow our competition to offer some of the same services that banks offer, but without the same restraints. So we need to get very much involved, and the way to do it is to use all of the tools we have at our disposal, be aggressive, and provide the very best service on a continual basis.

In conclusion, the seasonal borrowing privilege has been an attempt to provide credit through the banks on a seasonal basis, at those times when there is an outflow of deposits and an inflow of loans. In my opinion, it has worked fairly well, but it is rather restrictive, and is a last resort.

Bankers should be motivated to compete aggressively for agricultural loans and have an assurance of fund availability, for there is a continuing need for loans in agriculture. Whether during inflationary times or during periods of monetary restraint, it makes no difference. There is always a demand for production credit in agriculture.

We need to maintain a duality in our credit system. It will be good for the customer, and it will make for better management both in banking and the PCA's. The Farm Credit System has provided an excellent source of credit, but it shouldn't have it all its own way. We don't need a central agricultural bank. However, if a satisfactory source of funding for the rural banks is not found, we may well wind up with one system anyway.